

SOLTA MEDICAL INC  
Form 10-Q  
May 03, 2013  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended March 31, 2013**

.. **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File Number: 001-33123**

**SOLTA MEDICAL, INC.**

**(Exact name of registrant as specified in its charter)**

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**68-0373593**  
(I.R.S. Employer  
Identification No.)

**25881 Industrial Boulevard, Hayward, California 94545**  
(Address of principal executive offices) (Zip Code)

**(510) 782-2286**  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a small reporting company. See definition of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated Filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of April 30, 2013, 79,414,304 shares of the registrant's common stock were outstanding.

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Solta Medical , Thermage , Fraxel , Isolaz , CLARO , Clear + Brilliant , Liposonix , and VASER are registered trademarks of Solta Medical and its subsidiaries in the United States and other countries. Other trademarks, trade names and service marks appearing in this document are the property of their respective owners.

**Table of Contents****PART 1. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS (unaudited)**

Solta Medical, Inc.

**CONDENSED CONSOLIDATED BALANCE SHEETS***(in thousands of dollars, except share and per share data)***(Unaudited)**

	March 31, 2013	December 31, 2012
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 26,990	\$ 38,097
Accounts receivable, net	21,607	20,570
Inventories	21,254	16,611
Prepaid expenses and other current assets	5,952	8,476
<b>Total current assets</b>	<b>75,803</b>	<b>83,754</b>
Property and equipment, net	7,694	6,401
Purchased intangible assets, net	61,232	42,428
Goodwill	103,998	96,620
Other assets	818	520
<b>Total assets</b>	<b>\$ 249,545</b>	<b>\$ 229,723</b>
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Liabilities:		
Accounts payable	\$ 9,393	\$ 7,283
Accrued liabilities	13,980	17,343
Current portion of contingent consideration liability	34,200	21,400
Current portion of deferred revenue	3,712	3,985
Short-term borrowings	9,669	8,345
Customer deposits	662	637
<b>Total current liabilities</b>	<b>71,616</b>	<b>58,993</b>
Deferred revenue, net of current portion	656	683
Term loan, net of current portion	15,376	18,063
Non-current tax liabilities	2,492	2,478
Contingent consideration liability	29,000	38,500
Other liabilities	1,196	899
<b>Total liabilities</b>	<b>120,336</b>	<b>119,616</b>
Contingencies (Note 7)		
Stockholders' equity:		
Preferred stock, \$0.001 par value:		
10,000,000 shares authorized, none issued and outstanding		
Common stock, \$0.001 par value:		

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100,000,000 shares authorized, 79,337,751 and 68,795,987 shares issued and outstanding at March 31, 2013 and December 31, 2012, respectively.	79	69
Additional paid-in capital	242,176	220,489
Accumulated deficit	(113,046)	(110,451)
Total stockholders' equity	129,209	110,107
Total liabilities and stockholders' equity	\$ 249,545	\$ 229,723

The accompanying notes are an integral part of these condensed consolidated financial statements.

**Table of Contents****Solta Medical, Inc.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS***(in thousands of dollars, except share and per share data)***(Unaudited)**

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
Net revenue	\$ 34,523	\$ 32,454
Cost of revenue	12,844	12,211
Gross margin	21,679	20,243
<b>Operating expenses</b>		
Sales and marketing	14,207	13,946
Research and development	5,335	5,305
General and administrative	6,977	4,660
Remeasurement of contingent consideration liability	(3,100)	4,700
Total operating expenses	23,419	28,611
Loss from operations	(1,740)	(8,368)
Interest income	9	3
Interest expense	(692)	(351)
Other expense, net	(95)	(26)
Loss before income taxes	(2,518)	(8,742)
Income tax provision	77	57
Net loss	\$ (2,595)	\$ (8,799)
Net loss per share:		
Basic and diluted	\$ (0.04)	\$ (0.14)
Weighted average shares outstanding used in calculating net loss per common share:		
Basic and diluted	72,113,007	61,352,524

The accompanying notes are an integral part of these condensed consolidated financial statements.

**Table of Contents****Solta Medical, Inc.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS***(in thousands of dollars)***(Unaudited)**

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
<b>Cash flows from operating activities</b>		
Net loss	\$ (2,595)	\$ (8,799)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2,871	2,673
Loss on disposal of property, plant and equipment		7
Stock-based compensation	1,200	1,140
Contingent consideration fair value adjustment	(3,100)	4,700
Tax expense from stock options exercises	(3)	
Loan warrant discount amortization	118	24
Final payment accrual on debt financings	248	133
Provision for doubtful accounts	31	116
Write-down of excess and obsolete inventory	44	87
Change in assets and liabilities:		
Accounts receivable	1,693	(1,133)
Inventories	(1,448)	(981)
Prepaid expenses and other current assets	308	489
Other assets	67	
Accounts payable	266	664
Accrued and other liabilities	(3,322)	(1,122)
Deferred revenue	(409)	(391)
Customer deposits	25	572
Deferred rent	7	24
<b>Net cash used in operating activities</b>	<b>(3,999)</b>	<b>(1,797)</b>
<b>Cash flows from investing activities</b>		
Acquisition of property and equipment	(681)	(669)
Payments for acquisitions, net of cash acquired	(4,243)	
<b>Net cash used in investing activities</b>	<b>(4,924)</b>	<b>(669)</b>
<b>Cash flows from financing activities</b>		
Repayment of loan agreements	(1,482)	(4,598)
Cash settlement of vested restricted stock units	(937)	(469)
Proceeds from exercise of stock options	235	151
Proceeds from loan agreement borrowings		1,750
<b>Net cash used in financing activities</b>	<b>(2,184)</b>	<b>(3,166)</b>
Net decrease in cash and cash equivalents	(11,107)	(5,632)
Cash and cash equivalents at beginning of period	38,097	17,417
Cash and cash equivalents at end of period	\$ 26,990	\$ 11,785

**Supplemental disclosure of cash flow information**

Cash paid for interest	\$ 331	\$ 194
Cash paid (refunded) for taxes	30	(3)
Accounts payable and accrued liabilities related to property and equipment purchases	301	347
Issuance of common stock for vested restricted stock units	2,579	1,444

The accompanying notes are an integral part of these condensed consolidated financial statements.



**Table of Contents****Solta Medical, Inc.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS***(in thousands of dollars, except share and per share amounts)***(Unaudited)****NOTE 1 THE COMPANY AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES*****Background***

Solta Medical, Inc. (the Company) develops, manufactures, and markets aesthetic energy devices to address a range of issues, including skin resurfacing and skin rejuvenation, skin tightening and body contouring, and acne reduction. The Company was incorporated in California on January 11, 1996 as Thermage, Inc. and reincorporated in Delaware on September 10, 2001. The Company commercially launched its first products in October 2002.

***Basis of Presentation***

The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the annual consolidated financial statements and, in the opinion of management, reflect all adjustments, which include only normal recurring adjustments, necessary to state fairly the Company's financial position as of the date of the interim balance sheet and results of operations and cash flows for the interim periods. The results for the three months ended March 31, 2013 are not necessarily indicative of the results to be expected for the year ending December 31, 2013 or for any other interim period or for any future year.

These unaudited interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes for the year ended December 31, 2012 included in the Company's Annual Report on Form 10-K.

***Significant Accounting Policies***

The Company's significant accounting policies that are disclosed in the Company's Annual Report on Form 10-K filed on March 6, 2013 have not changed since December 31, 2012.

***Segment Information***

The Company operates in one business segment, which encompasses the developing, manufacturing and marketing of aesthetic energy devices. Management uses one measurement of profitability and does not segregate its business for internal reporting. Long-lived assets are primarily maintained in the United States. The Chief Operating Decision Maker is the Chairman, President and Chief Executive Officer of the Company.

The following table summarizes net revenue by product:

	<b>Three Months Ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
Systems	\$ 13,782	\$ 14,142
Tips and other consumables	18,897	16,778
Net revenue from products	32,679	30,920
Services and other	1,844	1,534
<b>Total net revenue</b>	<b>\$ 34,523</b>	<b>\$ 32,454</b>



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The following table summarizes net revenue by geographic region:

	Three Months Ended March 31,	
	2013	2012
North America	\$ 13,833	\$ 16,985
Asia Pacific	14,241	10,163
Europe/Middle East	5,307	4,426
Rest of the world	1,142	880
<b>Total net revenue</b>	<b>\$ 34,523</b>	<b>\$ 32,454</b>

**NOTE 2 NET LOSS PER COMMON SHARE**

Basic net loss per share is computed by dividing the net loss for the period by the weighted average number of common shares outstanding during the period.

Diluted net loss per share attributed to common shares is computed by dividing the net loss attributable to common shares for the period by the weighted average number of common and potential common shares outstanding during the period, if the effect of each class of potential common shares is dilutive. Potential common shares include common stock subject to repurchase rights and shares of common stock issuable upon the exercise of stock options and warrants and shares of common stock issuable under the Employee Stock Purchase Plan and restricted stock units. The dilutive effect of potential common shares is reflected in diluted net loss per share by application of the treasury stock method, which includes consideration of stock-based compensation.

Diluted net loss per share is the same as basic net loss per share for all periods presented because any potential dilutive common shares were anti-dilutive. Such potentially dilutive shares are excluded from the computation of diluted net loss per share when the effect would be to reduce net loss per share. Therefore, in periods when a loss is reported, the calculation of basic and diluted loss per share results in the same value.

	Three Months Ended March 31,	
	2013	2012
<b>Historical net loss per share:</b>		
Numerator:		
Net loss	\$ (2,595)	\$ (8,799)
Denominator:		
Weighted-average common shares outstanding used in calculating basic and diluted net loss per share	72,113,007	61,352,524
Basic and diluted net loss per share	\$ (0.04)	\$ (0.14)

The following outstanding options, warrants, common stock issuable under the Employee Stock Purchase Plan and restricted stock units were excluded from the computation of diluted net loss per common share for the periods presented because including them would have had an antidilutive effect:

	Three Months Ended March 31,	
	2013	2012
Options to purchase common stock	5,428,429	5,712,183

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Common stock warrants	4,586,971	4,414,191
Restricted and market-based stock units	2,842,529	2,633,793
Common stock issuable under Employee Stock Purchase Plan	173,452	163,830

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**NOTE 3 SOUND SURGICAL ACQUISITION**

On January 29, 2013, the Company, a wholly-owned subsidiary of the Company, Argonaut Limited Liability Company ( Merger Sub ), Sound Surgical Technologies LLC, ( Sound Surgical ) and Inlign CP III, LLC, entered into an Agreement and Plan of Merger (the Merger Agreement ), pursuant to which, the Company has agreed to acquire all of the outstanding membership interests of Sound Surgical by way of a merger of Merger Sub with and into Sound Surgical with Sound Surgical continuing as the surviving corporation and a wholly-owned subsidiary of the Company (the Merger ).

On February 26, 2013, the Company completed the acquisition of Sound Surgical in accordance with the Merger Agreement for an aggregate of (i) 9,732,824 shares of the Company s common stock (the Closing Shares ) issued to Sound Surgical s unit holders and (ii) approximately \$4,377 in cash, which includes adjustments to account for Sound Surgical s working capital and cash balances at closing, to such holders and in respect of certain obligations of Sound Surgical outstanding at the closing. The Closing Shares have a fair value of \$21,200 based on the per share price equal to the volume-weighted average of the closing sales prices for the Company s common stock on the NASDAQ Stock Market for a specified period prior to the date of the Merger Agreement (the Closing Share Price ) and applied discounts for lack of marketability.

In addition, the Merger Agreement provides that the Company will issue additional shares of its common stock (the Earn-Out Shares ) to unit holders of Sound Surgical upon the achievement of certain revenue milestones in 2013 from the sale of Sound Surgical products. The Earn-Out Shares, if any, are issuable in the first quarter of 2014. The maximum number of Earn-Out Shares issuable under the Merger Agreement is 3,625,954 shares, with an aggregate value of \$9,500 in total based on the Closing Share Price. The fair value of the total contingent consideration recognized on the acquisition date of \$6,400 was estimated by calculating a probability weighted expected earn-out, divided by the Closing Share Price as agreed to in the Merger Agreement, then multiplied by Solta s end of day stock price on the acquisition date, and finally discounted by a lack of marketability discount factor of 11.5%. Also, the Company assumed the Sound Surgical Louisville, Colorado, facility lease. The Company expects to maintain this facility lease and over the next 12 months, and will integrate Sound Surgical into its existing worldwide operations.

As of March 31, 2013, the fair value of this contingent consideration liability has been decreased to \$6,100 to reflect the updated fair value estimate of the liability and accordingly \$300 was recognized as a credit in the condensed consolidated statement of operations during the three months ended March 31, 2013 (see note 4 regarding Level 3 unobservable inputs used at March 31, 2013 to measure the contingent consideration liability for Sound Surgical). The decrease in the updated fair value of the contingent consideration is due to changes in the Company s stock price at March 31, 2013 and accretion of the liability. If the Company s actual results differ from those probability-weighted earnout estimates, the contingent consideration liability will be adjusted accordingly.

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The following summarizes the preliminary purchase price allocation of the Sound Surgical acquisition as of the acquisition date. Due to the timing of the acquisition, some amounts are subject to change within the measurement period for adjustments of the acquisition consideration based on the final determination of Sound Surgical's working capital:

Cash	\$ 134
Accounts receivable	2,761
Inventory	3,430
Prepaid expenses and other assets	684
Property and equipment	1,222
Intangible assets:	
VASER trade name	1,500
Customer relationships	12,500
Core/Developed Technology	6,800
Goodwill	7,378
Other long term assets	364
Total assets acquired	36,773
Liabilities assumed:	
Accounts payable	1,814
Accrued liabilities	2,953
Deferred revenue	22
Other liabilities	7
Total liabilities acquired	4,796
Net acquired assets	\$ 31,977

Of the total original purchase price of \$31,977, \$20,800 was allocated to amortizable intangible assets, which are being amortized using a straight-line method over their respective estimated useful lives of five to nine years. The valuation of identified intangible assets acquired was based on management's estimates, currently available information and reasonable and supportable assumptions. The allocation was based on the fair value of these assets determined using the income approach. The income approach uses a discounted cash flow model. The Company calculated the present value of the expected future cash flows attributable to the acquired intangibles using an 18.0% discount rate. With respect to intangible assets, there are several methods available under the income approach to quantify fair value. The Company used two methods to quantify fair value of the acquired intangibles at the acquisition date. The excess earnings method was used for customer relationships and the relief from royalties method was used for the developed technology and trade name intangibles with after-tax royalty rates of 6.5% and 0.7%, respectively.

The Company allocated the residual value of \$7,378 to goodwill. Goodwill represents the excess of the purchase price over the fair value of the net tangible and intangible assets acquired. Goodwill is expected to be deductible over 15 years for tax purposes. The factors that contributed to a premium in the purchase price and the resulting recognition of goodwill were:

expanded base of industry knowledge and expertise; and

expansion of the Company's global presence thereby increasing market penetration.

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For the period from February 26, 2013 to March 31, 2013, revenue from the sales of Sound Surgical products was not significant. Net income associated with Sound Surgical products and operations cannot be determined given the integration of Sound Surgical's operations within the Company. The Company's consolidated financial statements include the results of operations of Sound Surgical from the date of acquisition through March 31, 2013.

During the three months ended March 31, 2013, the Company incurred an aggregate of \$1,707 in acquisition and severance-related costs related to the acquisitions of Sound Surgical. During the three months ended March 31, 2012, the Company incurred an aggregate \$123 in acquisition and severance-related costs related to the acquisitions of Liposonix. These expenses are included in general and administrative expenses in the Company's consolidated statement of operations for the three months ended March 31, 2013 and 2012.

**NOTE 4 BALANCE SHEET DETAIL***Inventories, Net*

Inventories, net consist of the following:

	<b>March 31, 2013</b>	<b>December 31, 2012</b>
Raw materials	\$ 7,169	\$ 7,564
Work-in-process	281	418
Finished goods	13,804	8,629
	\$ 21,254	\$ 16,611

**Table of Contents****Intangible Assets**

The Company's intangible assets were acquired in connection with the acquisition of Reliant Technologies, Inc. on December 23, 2008, Aesthera Corporation on February 26, 2010, CLRS Technology Corporation on October 15, 2010, Liposonix on November 1, 2011, and Sound Surgical on February 26, 2013. The carrying amount and accumulated amortization expense of the acquired intangible assets at March 31, 2013 and December 31, 2012 were as follows:

<b>March 31, 2013</b>	<b>Estimated Useful Life</b>	<b>Gross Carrying Value</b>	<b>Accumulated Amortization</b>	<b>Net Carrying Value</b>
<b>Intangible assets amortized to cost of revenue:</b>				
Core technology	6 - 12 years	\$ 21,320	(\$7,964)	\$ 13,356
Product technology	7 - 9 years	31,970	(8,223)	23,747
Future royalties contract	10 years	3,890	(584)	3,306
		57,180	(16,771)	40,409
<b>Intangible assets amortized to operating expenses:</b>				
Trade Names	6 - 10 years	6,580	(1,998)	4,582
Customer relationships	4 - 12 years	19,210	(2,969)	16,241
		25,790	(4,967)	20,823
<b>Total intangible assets</b>		<b>\$ 82,970</b>	<b>(\$21,738)</b>	<b>\$ 61,232</b>
<b>December 31, 2012</b>	<b>Estimated Useful Life</b>	<b>Gross Carrying Value</b>	<b>Accumulated Amortization</b>	<b>Net Carrying Value</b>
<b>Intangible assets amortized to cost of revenue:</b>				
Core technology	6 - 12 years	\$ 21,320	(\$7,460)	\$ 13,860
Product technology	7 - 9 years	25,170	(7,388)	17,782
Future royalties contract	10 years	3,890	(486)	3,404
		50,380	(15,334)	35,046
<b>Intangible assets amortized to operating expenses:</b>				
Product development contract	1.9 years	620	(620)	
Non-compete agreement	2 years	500	(500)	
Trade name	6 - 10 years	5,080	(1,832)	3,248
Customer relationships	4 - 12 years	6,710	(2,576)	4,134
		12,910	(5,528)	7,382
<b>Total intangible assets</b>		<b>\$ 63,290</b>	<b>(\$20,862)</b>	<b>\$ 42,428</b>



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The Company has included amortization of acquired intangible assets directly attributable to revenue-generating activities in cost of revenue. The Company has included amortization of acquired intangible assets not directly related to revenue-generating activities in operating expenses. During the three months ended March 31, 2013, the Company recorded amortization expense in the amount of \$1,437 to cost of revenue and \$559 to operating expenses, and during the three months ended March 31, 2012, the Company recorded amortization expense in the amount of \$1,377 to cost of revenue and \$358 to operating expenses.

As of March 31, 2013, the total expected future amortization related to the Company's existing intangible assets, is as follows:

	Amortization included in Cost of Revenue	Amortization included in Operating Expense	Total Amortization Expense
2013	\$ 4,690	\$ 3,132	\$ 7,822
2014	6,254	4,135	10,389
2015	6,225	3,862	10,087
2016	4,610	3,690	8,300
2017 and thereafter	18,630	6,004	24,634
	\$ 40,409	\$ 20,823	\$ 61,232

The Company tests its long-lived assets for impairment if events or changes in circumstances indicate that the assets may be impaired. No impairment indicators of intangibles and long-lived assets were identified through March 31, 2013. There can be no assurance that future long-lived asset impairments will not occur.

**Goodwill**

The changes in the carrying amount of goodwill are as follows:

	March 31, 2013	December 31, 2012
Balance at beginning of period	\$ 96,620	\$ 96,620
Addition from acquisition	7,378	
Balance at end of period	\$ 103,998	\$ 96,620

Goodwill represents the excess of the purchase price over the fair value of the net tangible and intangible assets acquired. The Company tests goodwill for impairment at least annually or more frequently if events or changes in circumstances indicate that this asset may be impaired. The goodwill test is based on the Company's single operating segment and reporting unit structure. No goodwill impairment was identified through March 31, 2013. There can be no assurance that future goodwill impairments will not occur.

**Accrued Liabilities**

Accrued liabilities consist of the following:

	March 31, 2013	December 31, 2012
Payroll and related expenses	\$ 4,680	\$ 6,723
Accrued claims and settlements	189	3,189
Standard warranty	1,625	1,724

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Professional fees	746	662
Other	6,740	5,045
	\$ 13,980	\$ 17,343

### ***Fair Value of Financial Instruments***

Fair value is a market-based measurement that is determined based on assumptions that market participants would use in pricing an asset or liability. This hierarchy requires the Company to use observable market data, when available, and to minimize the use of unobservable inputs when determining fair value. A fair value hierarchy prioritizes the inputs used in measuring fair value as follows:

Level 1 - Observable inputs, such as quoted prices in active markets for identical assets and liabilities.

Level 2 - Inputs other than the quoted prices in active markets that are observable either directly or indirectly at the measurement date and for the duration of the instruments anticipated life.

Level 3 - Unobservable inputs in which there is little or no market data and that are significant to the fair value of the assets and liabilities and which reflect the Company's best estimate of what market participants would use in pricing the asset or liability at the measurement date.

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The Company considers all highly liquid investments with an original maturity of three months or less at the time of purchase to be cash equivalents. The Company's cash equivalents, which are money market funds and other instruments that mature in three months or less at the time of purchase, are classified within Level 1 of the fair value hierarchy because they are valued using quoted market prices for identical assets that the Company has the ability to assess at the measurement date. On a recurring basis, the Company measures its cash equivalents at fair value.

Carrying amounts of the Company's other financial instruments approximate their fair values due to their short maturities. The carrying amounts of other assets and liabilities approximate their fair values based upon their nature and size.

The carrying value of the Company's term loans under the credit facility and the subordinated debt facility as reported in the condensed consolidated balance sheets approximates fair value. The fair values of the Company's credit facility and subordinated debt facility are measured based on Level 3 inputs such as borrowing rates available to the Company for loans with similar terms.

The Company's contingent consideration liability is classified within Level 3 of the fair value hierarchy because some of the inputs used to value the liability are unobservable and developed by the Company using its own assumptions at March 31, 2013. At the end of each reporting period, the Company remeasures its contingent consideration liability at fair value.

The unobservable inputs at March 31, 2013 are as follows:

Level 3 Fair Value Measurement	Fair Value at March 31, 2013	Valuation Technique	Unobservable Input	Input %
Contingent consideration liability:				
Liposonix	\$ 57,100	Discounted cash flow	Weighted average cost of capital	21.7%
			Long term discount rate	21.5%
Sound Surgical	\$ 6,100	Probability weighted earnout	Discount for lack of marketability	11.0%
	\$ 63,200			

The unobservable inputs at December 31, 2012 are as follows:

Level 3 Fair Value Measurement	Fair Value at December 31, 2012	Valuation Technique	Unobservable Input	Input %
Contingent consideration liability:				
Liposonix	\$ 59,900	Discounted cash flow	Weighted average cost of capital	25.2%
			Long term discount rate	25.0%

The significant unobservable inputs used in the fair value measurement of the Company's contingent consideration liability are weighted average cost of capital, long term discount rate and discount for lack of marketability. Significant increases or decreases in any of these inputs in isolation would result in a significantly higher or lower fair value measurement. Generally, a change in the assumption used for the weighted average cost of capital is accompanied by a directionally similar change in the assumption used for the long term discount rate.

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The change in the value of the contingent consideration liability is summarized below:

Fair value at December 31, 2012	\$ 59,900
Additional contingent consideration liability resulting from the Sound Surgical acquisition	6,400
Change in fair value of the Liposonix contingent consideration liability recorded as a credit	(2,800)
Change in fair value of the Sound Surgical contingent consideration liability recorded as a credit	(300)
<b>Fair value at March 31, 2013</b>	<b>\$ 63,200</b>

As of March 31, 2013 and December 31, 2012, \$34,200 and \$21,400, respectively, of the contingent consideration liability was classified as current, and \$29,000 and \$38,500, respectively, was classified as non-current.

On September 12, 2011, the Company entered into a stock purchase agreement ( Purchase Agreement ) with Medicis Pharmaceutical Corporation ( Medicis ) pursuant to which the Company agreed to acquire from Medicis all the outstanding shares of Medicis Technologies Corporation (f/k/a LipoSonix, Inc.) ( Liposonix ). The Company closed the transaction on November 1, 2011. In connection with the transaction, the Company has agreed to pay to Medicis additional cash payments, which obligation will expire after approximately seven years, based upon, among other things, the achievement of year-to-year increases and specified targets in the adjusted net sales and adjusted gross profits of the Liposonix products, subject to the terms and conditions of the Purchase Agreement. The fair value of the total contingent consideration recognized on the acquisition date of \$26.6 million was estimated by applying a probability weighted discounted cash-flow approach. The fair value of the contingent consideration liability was increased to \$59,900 to update the fair value of the liability at December 31, 2012.

As of March 31, 2013, the fair value of this contingent consideration liability has been decreased to \$57,100 to reflect the updated fair value estimate of the liability, and accordingly a \$2,800 credit was recognized in general and administrative expenses within the condensed consolidated statement of operations during the three months ended March 31, 2013 (see above regarding Level 3 unobservable inputs used at March 31, 2013 to measure the contingent consideration liability). The decrease in the updated fair value of the contingent consideration was due primarily to changes in the Company's estimate of achievement in specified net sales and adjusted gross profit targets over the remaining six-year earnout period and accretion of the liability. If the Company's actual results differ from those estimates, the contingent consideration liability will be adjusted accordingly.

**NOTE 5 WARRANTY AND SERVICE CONTRACTS***Standard Warranty*

The Company currently accrues for the estimated cost to repair or replace or replace products under warranty at the time of sale and is recorded as a current liability in accrued liabilities. A summary of standard warranty accrual activity is shown below:

	Three Months Ended	
	March 31,	
	2013	2012
Balance at beginning of period	\$ 1,724	\$ 1,647
Additions from acquisition	123	
Accruals for warranties issued during the period	746	1,207
Settlements made during the period	(968)	(1,125)
<b>Balance at end of period</b>	<b>\$ 1,625</b>	<b>\$ 1,729</b>



**Table of Contents*****Extended Warranty Service Contracts***

The Company sells extended warranty service contracts to its customers. At the time of sale, the Company defers the amounts billed for such service contracts. Deferred service contract revenue, included as deferred revenue on the balance sheet, is recognized on a straight-line basis over the period of the applicable extended warranty contract. A summary of extended warranty contract activity is shown below:

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2013</b>	<b>2012</b>
Balance at beginning of period	\$ 3,039	\$ 3,256
Additions from acquisition	87	
Payments received	1,404	892
Revenue recognized	(1,210)	(1,120)
Balance at end of period	\$ 3,320	\$ 3,028

As of March 31, 2013 and December 31, 2012, \$2,663 and \$2,356, respectively, of the extended warranty contracts was classified as current, and \$656 and \$683, respectively, was classified as non-current. The Company incurred costs of \$537 and \$366 under extended warranty contracts during the three months ended March 31, 2013 and March 31, 2012, respectively.

**NOTE 6 LOAN AND SECURITY AGREEMENTS**

The Company entered into a Loan and Security Agreement (the *Loan Agreement*) with Silicon Valley Bank (the *Lender*) on March 9, 2009, with subsequent amendments through March 2013.

On March 18, 2013, the Company entered into the ninth amendment to the Loan Agreement which provided for an early termination option on the revolving line of credit prior to the maturity date, provided an early termination fee of \$240 is paid; a fully earned, non-refundable facility fee of \$120 due on the effective date of the ninth amendment and on the earlier of (1) the first anniversary of the Amendment or (2) the date the revolving line of credit is terminated early; an increase of credit available under the revolving line of credit from \$8,000 to \$12,000; an extension to the maturity date of borrowings under the revolving line of credit to March 18, 2015; amendments to the financial covenants, including changes to the liquidity ratio, the fixed charge coverage ratio and the leverage ratio; consent to the acquisition of Sound Surgical Technologies LLC; and the addition of Sound Surgical Technologies LLC as a *Guarantor* under the Loan and Security Agreement, and associated security agreements from it.

At March 31, 2013, there was no outstanding balance on the revolving loan facility, \$15,600 was outstanding as secured term loans under the Loan Agreement, \$10,000 was outstanding on the subordinated debt facility that the Company entered into in August 2012 with the Lender and \$555 was remaining as loan warrant discount. As of March 31, 2013, the Loan Agreement contains financial covenants requiring the Company to maintain a minimum liquidity, a maximum leverage ratio and a minimum fixed charge coverage ratio. The Company was in compliance with these covenants as of March 31, 2013.

**NOTE 7 CONTINGENCIES*****Litigation Matters***

From time to time, the Company is involved in litigation relating to claims arising from the ordinary course of business. The Company routinely assesses the likelihood of any adverse judgments or outcomes related to legal matters and claims, including those involving its intellectual property protection, as well as ranges of probable losses. A determination of the amount of the reserves required, if any, for these contingencies is made after thoughtful analysis of each known issue and an analysis of historical experience. In the cases where the Company believes that a reasonably possible loss exists, it discloses the facts and circumstances of the litigation, including an estimate range, if possible. All legal expenses, including those related to intellectual property protection, are expensed as they are incurred.

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On December 21, 2009, a complaint was filed in the Santa Clara County Superior Court by three former stockholders of Reliant against Reliant and certain former officers and directors of Reliant in connection with the Company's acquisition of Reliant, which closed on December 23, 2008. The complaint purports to be brought on behalf of the former common stockholders of Reliant. As a result of the acquisition, a successor entity to Reliant, Reliant Technologies, LLC, became the Company's wholly-owned subsidiary. One member of the Company's Board of Directors and the Company's former Chief Technology Officer and former member of the Company's Board of Directors are among the defendants named in the complaint. The principal claim, among others, is that Reliant violated the California Corporations Code by failing to obtain the vote from a majority of holders of Reliant's common stock prior to the consummation of the acquisition. The complaint also purports to challenge disclosures made by Reliant in connection with its entry into the acquisition and alleges that the defendants failed to maximize the value of Reliant for the benefits of Reliant's common stockholders. On August 2, 2010, defendants filed a motion to dismiss or stay the entire action based on a mandatory forum selection clause in the merger agreement which requires that claims related to the merger be litigated in Delaware. On September 28, 2010, the Court granted the defendants' motion to dismiss or stay, and stayed the action indefinitely. On January 20, 2012, the Court dismissed plaintiffs' case without prejudice. Plaintiffs have appealed. To date, the plaintiffs have not filed a complaint against the defendants in Delaware. The Company believes that this suit is without merit, and the Company intends to vigorously defend it. Although the Company does not expect that the final disposition of this litigation will have a material effect on its financial results, the Company expects to devote certain personnel and resources to resolve this litigation.

In January 2008, a product design complaint was filed against the Company in Federal District Court in Maryland. The individual plaintiff sought monetary damages, attorney's fees and costs of the action. Trial commenced on September 11, 2011. On September 29, 2011 a jury reached a verdict which was in favor of the plaintiff and awarded to the plaintiff an amount of total damages that is within the Company's insurance limits. In response to the verdict, the Company filed a motion for judgment notwithstanding the verdict and alternatively, a motion for a new trial. Those motions were denied by the court on August 2, 2012. The Company had meritorious reasons to contest the judgment and it filed an appeal to the Circuit Court of Appeals. The parties subsequently entered into a confidential settlement agreement on February 20, 2013. In light of the settlement, the Company's appeal became moot and the lawsuit is now resolved. The settlement did not have a material impact to the Company's financial results.

In April of 2011, Plaintiff, an individual, filed suit against Sound Surgical Technologies, LLC, Hector Oscar Molina, MD, and Molina Medical Management Group, Ltd. d/b/a Molina Medical Center in Texas District Court. The Plaintiff seeks unspecified damages, including pre-judgment, post-judgment and taxable costs. Plaintiff alleges that Sound Surgical Technologies, LLC was negligent for selling its product to an allegedly unqualified doctor and for providing inadequate training. The Company believes the allegations against Sound Surgical Technologies, LLC are without merit and there is adequate insurance to cover its defense.

On May 3, 2012, the Company and Reliant Technologies, which the Company acquired in December 2008, were served with a class action complaint filed in the United States District Court for the Northern District of California alleging that Reliant Technologies caused unsolicited fax advertisements to be sent to the plaintiff in 2008, in violation of the TCPA. Plaintiff, on behalf of itself and the putative class, seeks the greater of actual damages or statutory damages in the amount of \$500 per violation, treble damages for any willful violations, and injunctive relief. The parties have exchanged initial disclosures and discovery has commenced. The parties participated in private mediation on March 11, 2013, and settlement negotiations are ongoing. No trial date has been set. The Company is unable to reasonably estimate a range of loss at this time and intends to vigorously defend this action.

On December 7, 2012, Richard Clement ( plaintiff ), as putative representative for the shareholders of CLRS Technology Company ( CLRS ), filed suit against the Company in the Superior Court of the State of California for the County of Alameda. Plaintiff alleges that the Company breached its October 15, 2010 merger agreement with CLRS, and in particular alleges that the Company was required, but failed, to use its best efforts to market CLARO during the earnout period. The Company denies these allegations. Plaintiff asserts three causes of action: breach of contract, breach of the implied covenant of good faith and fair dealing, and violation of California Business and Professions Code §§17200 et seq. On April 19, 2013, the Court entered an order sustaining the Company's demurrer to the complaint, and granting plaintiff leave to file an amended complaint. On April 30, 2013, plaintiff filed his first amended complaint ( Complaint ) asserting only two causes of action: breach of contract, and breach of the implied covenant of good faith and fair dealing. The Company has ten days to demur or otherwise respond to the Complaint. The Company believes that the claims are without merit and intends to defend the action vigorously.

***Indemnifications***

In the normal course of business, the Company enters into contracts and agreements that contain a variety of representations and warranties and provide for general indemnifications. The Company's exposure under these agreements is unknown because it involves claims that may be made against the Company in the future, but have not yet been made. To date, the Company has not paid any claims or been required to defend any action related to its indemnification obligations. However, the Company may record charges in the future as a result of these indemnification obligations.

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In accordance with its certificate of incorporation, bylaws and individual indemnification agreements, the Company has indemnification obligations to its officers and directors and certain key employees for certain events or occurrences, subject to certain limits, while they are serving at the Company's request in such a capacity. There have been no claims to date and the Company has a director and officer insurance policy that may enable it to recover a portion of any amount paid for future claims.



**Table of Contents****NOTE 8 STOCK-BASED COMPENSATION**

Stock-based compensation expense is recognized using a fair-value based method for costs related to all share-based payments related to stock options granted to employees and non-employees, the Employee Stock Purchase Plan and restricted stock unit awards. The stock-based compensation expenses are allocated to cost of revenue, sales and marketing, research and development and general and administrative as follows:

	<b>Three Months ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
<b>Stock-based compensation expense:</b>		
Employee stock-based compensation expense	\$ 156	\$ 181
Employee stock purchase plan	75	72
Restricted and market based stock units	969	887
<b>Total stock-based compensation expense</b>	<b>\$ 1,200</b>	<b>\$ 1,140</b>

	<b>Three Months ended March 31,</b>	
	<b>2013</b>	<b>2012</b>
Cost of revenue	\$ 136	\$ 112
Sales and marketing	213	207
Research and development	139	162
General and administrative	712	659
<b>Total stock-based compensation expense</b>	<b>\$ 1,200</b>	<b>\$ 1,140</b>

During the three months ended March 31, 2013, under the 2006 Equity Incentive Plan, the board of directors approved the issuance of 669,382 shares of restricted stock units and 523,800 shares of market-based stock units to certain employees. The fair value of the restricted stock awards of \$1,724 was based on the closing stock market price on the date of award. These restricted stock units vest over three years. The fair value of the market-based stock units at the issuance date of \$1,275 was estimated using the Monte-Carlo simulation model which is a probabilistic approach for calculating the fair value of the awards. The Monte-Carlo simulation is a statistical technique used, in this instance, to simulate future stock prices of the Company and the Russell Microcap Index by using the following assumptions: expected volatility of 63.33% and 26.01%, correlation coefficients of 1.0 and 0.54631, risk-free interest rate of 0.37%, and contractual term of 2.9 years. The market stock units will vest over three years if certain market conditions are met. The market conditions are tied to the performance of the Company's common stock relative to the Russell Microcap Index.

**Table of Contents****ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the federal securities laws. These statements include, but are not limited to, introduction of new procedures and associated treatment tips in the future; sales organization growth; growth in international sales and expansion into new international markets; and our belief that our cash, cash equivalents and marketable investments, along with our credit facility will satisfy our anticipated cash requirements. These statements are subject to risks and uncertainties that could cause actual results and events to differ materially from those expressed or implied by such forward-looking statements. For a detailed discussion of these risks and uncertainties, see Risk Factors section in Item 1A of this Quarterly Report on Form 10-Q. We caution the reader not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date of this Form 10-Q. We undertake no obligation to update forward-looking statements, which reflect events or circumstances occurring after the date of this Form 10-Q. We also encourage you to read the Critical Accounting Policies in Item 7 Management's Discussion and Analysis contained in Part II of our Annual Report on Form 10-K filed on March 6, 2013.*

**Overview**

We design, develop, manufacture and market aesthetic energy devices to address a range of issues, including skin resurfacing and skin rejuvenation, body tightening and body contouring, and acne reduction. Our products are patented and generally require Food and Drug Administration (FDA) clearance in the United States and CE Mark approval in Europe prior to marketing. The product technologies we use include radio frequency (RF) energy, to heat and shrink collagen and tighten tissue while simultaneously cooling and protecting the surface of the skin; lasers for skin resurfacing and the treatment of actinic keratosis; intense pulsed light (IPL) for the treatment of mild to moderate acne and other dermatologic conditions; and high-intensity ultrasound for the destruction of subcutaneous adipose tissue for the purpose of waist circumference reduction.

We were incorporated in 1996 and received FDA clearance for our first Thermage RF system in 2002. Through a number of acquisitions, we added the Fraxel laser systems from our acquisition of Reliant Technologies, Inc. in December 2008; the Isolaz (IPL) system from our acquisition of Aesthera Corporation in February 2010; the CLARO (IPL) personal care acne treatment device from our acquisition of CLRS Technology Corporation in October 2010, the Liposonix system from our acquisition of Medicis Technologies Corporation in November 2011, and the VASER system from our acquisition of Sound Surgical Technologies LLC in February 2013. In addition, FDA clearance for the Clear + Brilliant laser system and the second generation Liposonix system were received in May and October 2011, respectively.

Net revenue for the three months ended March 31, 2013 increased 6% or \$2.0 million, to \$34.5 million, from \$32.5 million in the same period in 2012, due primarily to the sale of VASER products acquired in the acquisition of Sound Surgical Technologies LLC in February 2013. Our business continued to be impacted by the weakness in global economic conditions and tight credit markets, which we believe have continued to contribute to a slowdown in customer purchase decisions. The tight credit markets may have limited the ability of some of our customers to obtain financing for the purchase of our products. In response to the continuing difficulties in the economy, we have implemented a number of initiatives in response to the tight worldwide credit market, including working with financing companies to identify attractive leasing or borrowing options for our customers as well as offering incentives to doctors who buy more than one of our brands.

**Acquisition of Sound Surgical**

We completed the acquisition of Sound Surgical on February 26, 2013. See Note 3 of the Notes to Condensed Consolidated Financial Statements. The Company's consolidated financial statements include the results of operations of Sound Surgical from the date of acquisition through March 31, 2013.

**Significant Business Trends**

We derive revenue primarily from the sale of systems, treatment tips and consumables. For the three months ended March 31, 2013 and 2012, we derived 55% and 52% respectively, of our revenue from treatment tips and consumable sales, and 40% and 44% respectively, of our revenue from system sales. The balance of our revenue is derived from service, research and development, shipping and royalty revenue.

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We market our products in North America to physicians, primarily dermatologists and plastic surgeons, through a direct sales force and internationally through a network of independent distributors and our direct sales force in certain countries. In the three months ended March 31, 2013 and 2012, we derived 40% and 52%, respectively, of our revenue from sales of our products and services within North America, and 60% and 48%, respectively, of our total sales outside of North America. We believe that a significant portion of our business will continue to come from international sales through increased penetration in countries where we currently sell our products, combined with expansion into new international markets. The percentages of our revenue by region are presented in the table below:

	Three Months Ended March 31,	
	2013	2012
North America	40%	52%
Asia Pacific	41%	31%
Europe/Middle East	16%	14%
Rest of the world	3%	3%
<b>Total net revenue</b>	<b>100%</b>	<b>100%</b>

Future operating results are difficult to predict accurately. We anticipate that our quarterly results of operations may fluctuate for the foreseeable future due to several factors, including prevailing economic conditions and our customers' access to credit, the timing of introduction and the degree of acceptance of future product offerings, unexpected interruptions and expenses related to our manufacturing operations, and the performance of our direct sales force and international distributors.

As new or enhanced products are introduced, we must successfully manage the transition from older products in order to minimize disruption in customers' ordering patterns, avoid excessive levels of older product inventories, and ensure that enough supplies of new products can be delivered to meet customer demand.

**Significant Industry Factors**

The success of our business is subject to the impact of economic conditions on the growth of the industry and to our ability to continue to develop new products, applications and innovative technologies, obtain and maintain regulatory clearances for our products, protect our proprietary technology, and successfully market and distribute our products. Our industry is characterized by seasonally lower demand during the third calendar quarter of the year, when both physicians and prospective patients take summer vacations. Additionally, our industry is highly competitive and our success depends on our ability to compete successfully. Our business is sensitive to a number of factors that influence the levels of consumer spending, including political and economic conditions such as recessionary environments, the level of disposable consumer income, consumer debt, interest rates and consumer confidence. Declines in consumer spending on aesthetic procedures could have an adverse effect on our operating results. A detailed discussion of these and other factors that impact our business is provided in the Risk Factors section in this Quarterly Report on Form 10-Q.

**Results of Operations****Three Months Ended March 31, 2013 and 2012**

*Net Revenue.* Revenue is derived from the sales of systems, treatment tips and other consumables, and service and other revenue. Net revenue was \$34.5 million for the three months ended March 31, 2013, an increase of \$2.0 million, or 6%, compared to \$32.5 million for the three months ended March 31, 2012. The increase in revenue was due primarily from the sale of the new VASER products that launched in March 2013, an increase of net tips and consumable sales and an increase in handpiece sales. The increase was partially offset by a decrease in existing system sales and system upgrades which was due primarily to competitive market pressures and a manufacturing issue with the Liposonix transducer treatment tip that we experienced in our North America regions. The Liposonix transducer manufacturing issue was corrected by the end of March, 2013. System sales for the three months ended March 31, 2013 was \$13.8 million, a decrease of \$0.4 million, or 3%, compared to \$14.1 million for the same period of 2012. Sale of treatment tips and other consumables increased by \$2.1 million or 13%, to \$18.9 million for the three months ended March 31, 2013 from \$16.8 million for the same period of 2012.

*Cost of Revenue.* Our cost of revenue consists primarily of material, labor and manufacturing overhead expenses. Gross margin was 63% of revenue for the three months ended March 31 2013, compared with 62% of revenue for the same period in 2012. The slight increase in gross

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margin when compared to the prior year period was primarily due a higher mix of tip sales, lower warranty expenses and manufacturing spending net of overhead absorption, partially offset by increased expenses related to higher manufacturing scrap material.

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*Sales and Marketing.* Sales and marketing expenses consist primarily of personnel related costs in our sales, marketing, clinical training, and customer service departments, customer-attended workshops, trade shows, advertising, public relations, marketing sponsorship programs, and marketing materials. Sales and marketing expenses for the three months ended March 31, 2013 were \$14.2 million, an increase of \$0.3 million, or 2%, compared to \$13.9 million for the same period in 2012. The increase was primarily attributable to an increase of \$0.2 million in advertising and marketing program expenses for launching our products in new markets, an increase of \$0.2 million in professional outside services, an increase of \$0.2 million in amortization of intangibles acquired in the Sound Surgical acquisition which closed in February 2013, and an increase of \$0.1 million in depreciation and allocated information technology and facility expenses, partially offset by a decrease of \$0.4 million in employee payroll, commissions and related travel and entertainment expenses.

*Research and Development.* Research and development expenses consist primarily of personnel costs, clinical and regulatory costs, material costs and quality assurance costs not directly related to the manufacturing of our products. Research and development expenses remained fairly constant at \$5.3 million for the three month periods ended March 31, 2013 and 2012. Compared to the prior year, employee payroll and related expenses increased by \$0.1 million, which was mainly due to increased headcount resulting from research and development personnel acquired in our Sound Surgical acquisition, and an increase of \$0.1 million in clinical studies and other research, offset by a decrease of \$0.2 million in professional outside services.

*General and Administrative.* General and administrative expenses consist primarily of personnel costs, legal and accounting fees, human resources costs and other general operating expenses. General and administrative expenses for the three month ended March 31, 2013 were \$7.0 million, an increase of \$2.3 million, or 50%, compared with \$4.7 million for the same period in 2012. The increase from the prior year period was primarily due to an increase of \$1.6 million in acquisition and severance related expenses resulting from the acquisition of Sound Surgical in February 2013. In addition, professional outside services increased by \$0.3 million, mostly legal services, employee payroll and related expenses increased by \$0.2 million, and there was an increase of \$0.2 million in additional excise taxes due to the new medical device excise tax effective January 1, 2013.

*Remeasurement of contingent consideration liability.* Remeasurement of the contingent consideration liability is the quarterly fair value adjustment of the contingent consideration liability associated with certain acquisitions. Adjustments can arise due to accretion of the liability as the Company approaches payment or for any changes to the assumptions used to measure the liability. For the three months ended March 31, 2013, the contingent consideration fair value adjustment was a \$3.1 million credit associated with the acquisitions of Liposonix and Sound Surgical, and for the three months ended March 31, 2012, the contingent consideration fair value adjustment was a \$4.7 million expense associated with the acquisition of Liposonix. The acquisition of Liposonix closed in the fourth quarter of 2011 and the acquisition of Sound Surgical closed in the first quarter of 2013. The decrease to the contingent consideration liability recorded in the first three months of 2013 was due primarily to changes in our estimates of achievement in specified net sales and adjusted gross profit targets over the remaining six-year Liposonix earnout period and changes in the company's stock price used to value the Sound Surgical contingent consideration liability. The increase to the contingent consideration liability recorded in the first three months of 2012 was due primarily to changes in our estimates of achievement in specified net sales and adjusted gross profit targets over the seven-year Liposonix earnout period.

*Interest Income.* Interest income consists primarily of interest income generated from our cash and cash equivalents. Interest income increased \$6,000 to \$9,000 for the three months ended March 31, 2013, from \$3,000 for the same period in 2012. The increase is primarily due to higher average cash and cash equivalent balances during the first quarter of 2013.

*Interest Expense.* Interest expense consists primarily of interest expense resulting from borrowings on the line of credit and term loans. Interest expense increased by \$0.3 million to \$0.7 million for the three months ended March 31, 2013 from \$0.4 million for the same period in 2012. The increase is primarily a result of the new subordinated debt facility we entered into in August 2012.

*Other Expense, net.* Net other expense consists primarily of activity resulting from foreign exchange gains and losses and activity from our equity investment. Net other expense was \$95,000 and \$26,000 in the three months ended March 31, 2013 and 2012, respectively. The net expense increase during the first quarter of 2013 is primarily due to higher foreign exchange losses from currency fluctuations when compared to the prior year.

*Income Tax Provision.* There was an income tax provision of \$77,000 and \$57,000 for the three month periods ended March 31, 2013 and 2012, respectively. The provisions for income taxes for the periods ended March 31, 2013 and 2012, primarily represents taxes in foreign and state jurisdictions and tax reserves for uncertain tax positions.

**Table of Contents****Stock-Based Compensation**

For the three months ended March 31, 2013 and 2012 employee and non-employee stock-based compensation expense has been allocated as follows (in thousands):

	Three Months ended March 31,	
	2013	2012
Cost of revenue	\$ 136	\$ 112
Sales and marketing	213	207
Research and development	139	162
General and administrative	712	659
<b>Total stock-based compensation expense</b>	<b>\$ 1,200</b>	<b>\$ 1,140</b>

**Reconciliation of GAAP to Non-GAAP Financial Measures**

The following presentation includes non-GAAP measures. Our non-GAAP measures are not meant to be considered in isolation or as a substitute for comparable GAAP measures. The Company believes that non-GAAP measures have limitations in that they do not reflect all of the amounts associated with the Company's results of operation as determined in accordance with GAAP and that these measures should only be used to evaluate the Company's results of operations in conjunction with the corresponding GAAP measures.

The non-GAAP financial measures presented are non-GAAP gross margin, non-GAAP gross margin as a percentage of sales, non-GAAP operating income, non-GAAP adjusted EBITDA, non-GAAP net income and non-GAAP net income per share. These non-GAAP financial measures, as defined by us, are adjusted to exclude one or more of the following items: in process research and development, amortization of acquired intangibles and other non-cash acquisition-related charges, severance expense, acquisition-related expenses, loss on investments and stock-based compensation expense.

We use non-GAAP financial measures as performance measures to supplement the financial information we present on a GAAP basis. We believe these non-GAAP financial measures provide useful information to investors and management for the reasons stated below.

Non-GAAP gross margin and non-GAAP gross margin as a % of sales provide useful information to investors regarding our gross margin by excluding from cost of sales non-cash items like amortization of acquisition related intangibles and stock-based compensation expenses. These costs are generally fixed at the time of acquisition or when the stock-based award is granted, are then expensed or amortized over several years and generally cannot be changed or influenced by management after acquisition or once granted. We further believe that excluding these charges can provide useful information to investors for the reasons stated in the footnotes to these respective items in the presentation that follows.

Non-GAAP operating income reflects our ongoing business in a manner that allows for meaningful period-to-period comparison and analysis of trends in our business, as it excludes expenses that may not be regarded as reflective of ongoing operating results like severance expenses and acquisition related in-process research and development expenses, as well as those discussed in non-GAAP gross margin above. We further believe that excluding the identified expenses can provide useful information to investors for the reasons stated in the footnotes to these respective items in the presentation that follows.

Non-GAAP Adjusted EBITDA enables investors to assess our compliance with financial covenants under its debt instruments. Our credit facility loans have financial covenants that use non-GAAP adjusted EBITDA as part of the measure.

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Non-GAAP net income and non-GAAP net income per share, by excluding non-cash and one-time expenses like those discussed in non-GAAP gross margin and non-GAAP operating income measures above, provide useful information to investors and others in understanding and evaluating our financial results and future prospects in the same manner as management and in comparing financial results across accounting periods.

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For a detailed explanation of the adjustments made to comparable GAAP measures and the reasons why management uses these adjustments, see items (1) - (6) below.

	Three Months Ended	
	March 31,	
	2013	2012
GAAP Gross margin	\$ 21,679	\$ 20,243
GAAP gross margin as % of sales	63%	62%
Non-GAAP adjustments to gross margin:		
GAAP Gross margin	\$ 21,679	\$ 20,243
Amortization and other non-cash acquisition related charges (1)	1,438	1,658
Stock-based compensation (4)	136	112
Non-GAAP gross margin	\$ 23,253	\$ 22,013
Non-GAAP gross margin as % of sales	67%	68%
GAAP loss from operations	(\$1,740)	(\$8,368)
Non-GAAP adjustments to net income (loss) from operations:		
Amortization and other non-cash acquisition related charges (1)	1,996	2,017
Remeasurement of contingent consideration liability (6)	(3,100)	4,700
Acquisition-related expenses (3)	1,394	93
Severance expenses (2)	313	30
Stock-based compensation (4)	1,200	1,140
Non-GAAP income from operations	\$ 63	(\$388)
Depreciation expenses (5)	875	938
Non-GAAP Adjusted EBITDA	\$ 938	\$ 550
GAAP net loss	(\$2,595)	(\$8,799)
Non-GAAP adjustments to net loss:		
Amortization and other non-cash acquisition related charges (1)	1,996	2,017
Remeasurement of contingent consideration liability (6)	(3,100)	4,700
Acquisition-related expenses (3)	1,394	93
Severance expenses (2)	313	30
Stock-based compensation (4)	1,200	1,140
Non-GAAP net loss	(\$792)	(\$819)
GAAP basic net loss per share	(\$0.04)	(\$0.14)
Non-GAAP adjustments to basic loss per share:		
Amortization and other non-cash acquisition related charges	\$ 0.03	\$ 0.03
Remeasurement of contingent consideration liability	(\$0.04)	\$ 0.08
Acquisition-related expenses	\$ 0.02	\$ 0.00
Severance expenses	\$ 0.00	\$ 0.00
Stock-based compensation	\$ 0.02	\$ 0.02
Non-GAAP basic net loss per share	(\$0.01)	(\$0.01)



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Non-GAAP diluted net loss per share	(\$0.01)	(\$0.01)
GAAP weighted average shares outstanding used in calculating basic net loss per share	72,113,007	61,352,524
GAAP weighted average shares outstanding used in calculating diluted net loss per share	72,113,007	61,352,524
Adjustments for dilutive potential common stock		
Weighted average shares outstanding used in calculating non-GAAP diluted net loss per share	72,113,007	61,352,524

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- (1) *Amortization and other non-cash acquisition-related charges* are non-cash charges, such as amortization of acquired intangibles, that can be impacted by the timing and magnitude of our acquisitions. We consider our operating results without these charges when evaluating our ongoing performance and/or predicting our earnings trends, and therefore exclude such charges when presenting non-GAAP financial measures. We believe the assessment of our operations excluding these costs is relevant to our assessment of internal operations and comparisons to the performance of other companies in our industry.
- (2) *Severance expenses (credits)* include acquisition related severance expenses (credits) and are disregarded by our management when evaluating and predicting earnings trends because these charges are unique to specific acquisitions, and are therefore excluded by us when presenting non-GAAP financial measures.
- (3) *Acquisition-related expenses* include direct costs of the acquisition and expenses related to acquisition integration activities. Examples of costs directly related to an acquisition include transaction fees, due diligence costs and certain legal costs related to acquired litigation which are included in general and administrative expenses in our statement of operations. These expenses vary significantly in size and amount and are disregarded by our management when evaluating and predicting earnings trends because these charges are unique to specific acquisitions, and are therefore excluded by us when presenting non-GAAP financial measures.
- (4) *Stock-based compensation expense* consist of expense relating to stock-based awards issued to employees, outside directors and non employees including stock options, restricted stock units, restricted stock units with performance-based vesting and our Employee Stock Purchase Plan. Because of varying available valuation methodologies, subjective assumptions and the variety of award types, we believe that the exclusion of stock-based compensation expense allows for more accurate comparisons of our operating results to our peer companies, and for a more accurate comparison of our financial results to previous periods. In addition, we believe it is useful to investors to understand the specific impact of stock-based compensation expenses on our operating results.
- (5) *Depreciation expense* includes depreciation and amortization of leasehold improvements, furniture and fixtures, machinery and equipment, software and computers and equipment. Our management excludes this charge from operating income (loss) to compute non-GAAP earnings before income taxes, depreciation and amortization.
- (6) *Remeasurement of contingent consideration liability* is a non-cash charge relating to the fair value adjustment, at the end of the reporting period, of the contingent consideration liability associated with certain acquisitions. We consider our operating results without these charges when evaluating our ongoing performance and/or predicting our earnings trends, and therefore exclude such charges when presenting non-GAAP financial measures. We believe the assessment of our operations excluding these costs is relevant to our assessment of internal operations and comparisons to the performance of other companies in our industry.

**Liquidity and Capital Resources**

On March 31, 2013, we had a working capital of \$4.2 million, which included \$27.0 million of cash and cash equivalents. In 2011, we substantially increased our outstanding indebtedness, and reduced our available cash balances, with our acquisition of Liposonix, and we expect to be required to make substantial future cash payments in respect of that transaction.

On March 18, 2013, we entered into the ninth amendment to the Loan and Security Agreement (the *Loan Agreement*) with Silicon Valley Bank (the *Lender*) which provided for an early termination option on the revolving line of credit prior to the maturity date, provided an early termination fee of \$0.2 million is paid; a fully earned, non-refundable facility fee of \$0.1 million due on the effective date of the ninth amendment and on the earlier of (1) the first anniversary of the Amendment or (2) the date the revolving line of credit is terminated early; an increase of credit available under the revolving line of credit from \$8 million to \$12 million; an extension to the maturity date of borrowings under the revolving line of credit to March 18, 2015; amendments to the financial covenants, including changes to the liquidity ratio, the fixed charge coverage ratio and the leverage ratio; consent to the acquisition of Sound Surgical; and the addition of Sound Surgical as a Guarantor under the Loan and Security Agreement, and associated security agreements from it. At March 31, 2013, \$0 was outstanding on the revolving loan facility, \$15.6 million was outstanding as secured term loans under the Loan Agreement, \$10.0 million was outstanding on the subordinated debt facility that we entered into in August 2012 with the Lender, and \$0.6 million was remaining as loan warrant discount. As of March 31, 2013, the Loan Agreement contains financial covenants requiring us to maintain a minimum liquidity, a maximum leverage ratio and a minimum fixed charge coverage ratio. We were in compliance with these covenants as of March 31, 2013. For further discussion of our credit facilities as of December 31, 2012, see Note 6 of the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2012 filed on March 6, 2013.

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Our future capital requirements depend on a number of factors, including the rate of market acceptance of our current and future products, the resources we devote to developing new products and supporting existing products, the required ramp-up of inventory for new products and contingent payments owed to Medicis from the Liposonix acquisition based on achievement against specified revenue and profit targets.

We expect to increase capital expenditures consistent with our anticipated growth in manufacturing, infrastructure and personnel. We also may increase our capital expenditures as we expand our product lines or invest to address new markets.

We believe that our current cash and cash equivalent balances, along with our existing revolving loan facility will meet our anticipated cash needs for working capital and capital expenditures for at least the next 12 months. Our future liquidity requirements may increase beyond currently expected levels if we fail to maintain compliance with covenants in our bank loan agreements or if unanticipated expenses or other uses of our cash arise. In addition, we achieved higher sales of the Liposonix products in the year ended December 31, 2012 than we had anticipated, and as a result, the 2013 contingent payment obligation to Medicis is approximately \$21.4 million. The fair value of the Liposonix contingent consideration due after 2013 was \$35.7 million at March 31, 2013. If sales of Liposonix products are higher than expected during the remainder of the six-year earn-out period, our contingent payment obligation to Medicis and our working capital requirements will grow beyond our current expectations. In such event we may need to secure additional financing beyond any cash generated from operations and cash available under our current credit facilities. Further, we have consummated acquisitions of other businesses in the past and continue to evaluate potential strategic acquisitions of complementary businesses, products or technologies. If we elect to complete additional acquisitions in the future our cash needs are likely to exceed the amount of cash we currently expect to have to fund our operations. In order to meet our future liquidity needs or to fund acquisitions, we may seek additional equity and/or debt financing. Additional financing may not be available on a timely basis on terms acceptable to us, or at all. Any future equity financing would result in dilution to our stockholders and future debt financing may subject us to restrictions on the operation of our business and on our ability to pursue business development opportunities. The availability of financing or merger opportunities will depend, in part, on market conditions, and the outlook for our company.

*Net Cash Used in Operating Activities.* Net cash used in operating activities was \$4.0 million for the three months ended March 31, 2013, compared to \$1.8 million used in the three months ended March 31, 2012. During the first three months of 2013, cash was used by a \$3.3 million decrease in accrued liabilities, an increase of \$1.4 million in inventory attributable to the ramp-up of inventory for our Clear + Brilliant and Liposonix products, a \$0.4 million decrease in deferred revenue, and \$1.2 million in net cash used from net loss after adjusting for non-cash items. These were partially offset by a \$0.3 million decrease in prepaid and other current assets, a \$0.3 million increase in accounts payable, and a \$1.7 million decrease in accounts receivable. During the first quarter of 2012, cash was used for a \$1.1 million increase in accounts receivable, a \$1.1 million decrease in accrued liabilities, a \$1.0 million increase in inventory attributable to the ramp-up of inventory for our new Clear + Brilliant and Liposonix products, a \$0.4 million decrease in deferred revenue, and \$0.1 million in net cash used from net loss after adjusting for non-cash items. These were partially offset by a decrease of \$0.5 million in prepaid and other current assets, a \$0.7 million increase in accounts payable and a \$0.6 million increase in customer deposits.

*Net Cash Used in Investing Activities.* Net cash used in investing activities was \$4.9 million for the first three months of 2013 compared with \$0.7 million cash used in investing activities during the same period in 2012. During the first three months of 2013, net cash of \$0.7 million was used for payments to acquire property and equipment and \$4.2 million was used for the acquisition of Sound Surgical, net of cash received. During the first three months of 2012, net cash of \$0.7 million, was used for payments to acquire property and equipment.

*Net Cash Provided by Financing Activities.* Net cash used in financing activities was \$2.2 million for the first three months of 2013 compared with \$3.2 million of net cash used in financing activities in the same period in 2012. During the three months of 2013, we made payments of \$1.5 million on our term loans and paid \$0.9 million to settle tax obligations on behalf of our employees for the issuance of restricted stock units. These were partially offset by the receipt of \$0.2 million in proceeds from exercise of stock options. During the first three months of 2012, we made net payments of \$2.8 million on our term and revolving loans and paid \$0.5 million to settle tax obligations on behalf of our employees for the issuance of restricted stock units, partially offset by \$0.2 million in proceeds from exercise of stock options.

**Off-Balance Sheet Arrangements**

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. In addition, we do not have any undisclosed borrowings or debt, and we have not entered into any synthetic leases. We are, therefore, not materially exposed to any financing, liquidity, market or credit risk that could arise if we engaged in such relationships.

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### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

#### ***Foreign Currency Risk***

Currently, most of our sales and purchases are denominated in U.S. dollars, although, future fluctuations in the value of the U.S. dollar may affect the price competitiveness of our products. We do not believe, however, that we currently have significant direct foreign currency exchange rate risk and have not hedged exposures denominated in foreign currencies.

#### ***Interest Rate Risk***

Changes in interest rates will impact our interest sensitive credit agreement and accordingly may impact interest expense. We have determined that if interest rates were to instantaneously increase (decrease) by 100 basis points, there would be no material impact to interest expense over a year period.

### **ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures.** Our management evaluated, with the participation of our Chief Executive Officer and our Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) of the Exchange Act of 1934, as amended) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms, and that such information is accumulated and communicated to management including our Chief Executive Officer and our Chief Financial Officer as appropriate to allow for timely decisions regarding required disclosure.

**Changes in Internal Control Over Financial Reporting.** There was no change in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

The Company is involved in litigation as discussed in Note 7 of the Notes to the Financial Statements disclosed in this Company's Quarterly Report on Form 10-Q.

In addition, from time to time, we are subject to legal proceedings and claims with respect to such matters as patents, intellectual property rights, product liability claims and contractual disputes with distributors, suppliers and others, arising out of the normal course of business. Litigating claims of these types, whether or not ultimately determined in our favor or settled by us, is costly and diverts the efforts of management and other personnel from normal business operations. The results of legal proceedings cannot be predicted with certainty. The Company does not believe the final disposition of these matters will have a material effect on the financial statements and future cash flows of the Company.

### **ITEM 1A. RISK FACTORS**

#### **Item 1A. Risk Factors**

##### **Risks Related to Our Business**

**Economic uncertainty has reduced and may continue to reduce patient demand for our products; if there is not sufficient patient demand for the procedures for which our products are used, practitioner demand for these systems could drop, resulting in unfavorable operating results.**

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The aesthetic industry in which we operate is particularly vulnerable to economic trends. The decision to undergo a procedure from one of our systems is driven by consumer demand. Most procedures performed using our systems are elective procedures, the cost of which must be borne by the patient, and are not reimbursable through government or private health insurance. In times of economic uncertainty or recession, individuals often reduce the amount of money that they spend on discretionary items, including aesthetic procedures. The general economic difficulties being experienced by our customers and the lack of availability of consumer credit for some of our customers are adversely affecting the market in which we operate.

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If the economic hardships our customers face continue or worsen, our business would be negatively impacted and our financial performance would be materially harmed in the event that any of the above factors discourage patients from seeking the procedures for which our products are used.

**We are totally dependent upon the success of our systems, which have a limited commercial history. If our products fail to achieve sufficient market acceptance, our business will suffer.**

We expect that sales of our systems, including our treatment tips, will account for substantially all of our revenue for the foreseeable future. We expect to continue to expand our line of systems and treatment tips. This may not occur when expected, or at all, which would negatively affect our anticipated revenue. Our systems may not significantly penetrate current or new markets. If demand for our systems does not increase as we anticipate, or declines, our business, financial condition and results of operations will be harmed.

**Our financial results may fluctuate unpredictably, making it difficult to forecast future performance.**

Our limited operating history makes it difficult for us to predict future performance. Historically, the demand for our systems has varied from quarter to quarter. A number of factors, over which we have limited or no control, may contribute to fluctuations in our financial results, such as:

delays in receipt of anticipated purchase orders;

seasonal variations in patient demand for aesthetic procedures;

the impact of general economic conditions on the demand for aesthetic procedures;

performance of our independent distributors;

the lack of credit available to physicians to finance capital equipment purchases;

positive or negative media coverage of our products or products of our competitors or our industry;

our ability to obtain further regulatory clearances or approvals;

delays in, or failure of, product and component deliveries by our subcontractors and suppliers;

changes in the length of the sales process;

the costs of litigation claims or adverse outcomes from legal proceedings;

customer response to the introduction of new product offerings;

fluctuations in foreign currency; and

excess or obsolete inventory charges.

**Our success depends on growing physician adoption of our systems and continued use of our treatment tips.**

Our target physician customers typically already own one or more aesthetic device products. Our ability to grow our business and convince physicians to purchase our systems and products depends on the success of our clinical and sales and marketing efforts. Our business model involves both a capital equipment purchase of our systems and continued purchases by our customers of our treatment tips. This may be a novel business model for many potential customers who may be used to competing products that are either exclusively capital equipment, such as many laser-based systems, or that are exclusively single-use products, such as Botox or dermal fillers. In addition, the lack of credit available to physicians to finance the purchase of systems may also impact the adoption of these systems. We must be able to demonstrate that the cost of our systems and the revenue that the physician can derive from performing procedures using our products are compelling when compared to the cost and revenue associated with alternative products. When marketing to plastic surgeons, we must also, in some cases, overcome a bias against non-invasive or minimally invasive aesthetic procedures. If we are unable to increase physician adoption of our systems and use of our treatment tips, our financial performance will be adversely affected.

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**We may not be able to achieve or sustain profitability even if we are able to generate significant revenue.**

We incurred a loss of \$38.0 and \$2.6 million for the year ended December 31, 2012 and for the three months ended March 31, 2013, respectively, despite revenue growth during these two periods. In the past, we have expanded our business and increased our expenses in order to grow revenue. We will have to increase our revenue while effectively managing our expenses in order to achieve sustained profitability. Our failure to achieve or sustain profitability could negatively impact the market price of our common stock.

**We may be required to raise additional capital and/or debt financing on unfavorable terms.**

We substantially increased our outstanding indebtedness, and reduced our available cash balances, with our acquisition of Liposonix, and we expect to make substantial future cash payments in respect of that transaction. During the year ended December 31, 2012, we substantially increased our estimate of the future cash payments due to Medicis. In addition, we borrowed \$10 million under a new subordinated debt facility in August 2012 and must commence the repayment of this facility and related fees over a period from June 1, 2013 to April 1, 2015. Further, if we fail to achieve sustained profitability and positive cash flow or if unanticipated expenses or other uses of cash arise, our liquidity needs may exceed our cash and cash equivalents and available credit facilities. In order to meet our liquidity needs, we may be required to seek additional equity and/or debt financing such as the sale of our common stock in the public offering that we completed in August 2012. Additional financing may not be available on a timely basis on terms acceptable to us, or at all, particularly in the short-term due to the current credit and equity market funding environments. The availability of financing will depend, in part, on market conditions, and the outlook for our company. Any future equity financing would result in substantial dilution to our stockholders. If we raise additional funds by issuing debt, we may not be able to obtain such debt with favorable terms, and we may be subject to limitations on our operations, through debt covenants or other restrictions. If adequate funds are not available with favorable terms, we may have to delay development of new products or reduce marketing, customer support or other resources devoted to our products. In addition, if we are unable to obtain financing as needed, we may come into breach of our outstanding loan covenants. Any of these factors could harm our business and financial condition.

**We are subject to fluctuations in the exchange rate of the U.S. dollar and foreign currencies.**

As a result of recent fluctuations in currency markets, our products priced in U.S. dollars may be more expensive relative to products of our foreign competitors, which could result in lower revenue and profit margins. We do not actively hedge our exposure to currency rate fluctuations. While we transact business primarily in U.S. dollars, and a significant proportion of our revenue is denominated in U.S. dollars, a growing proportion of our revenue and costs is denominated in other currencies, such as the Australian dollar, Euro, Japanese Yen, and British Pound Sterling. In addition, the functional currency of our foreign subsidiaries is the U.S. dollar. As a result, our financial performance could be adversely affected by changes in the exchange rates of these currencies to the U.S. dollar.

**We may not be successful in selling and marketing our new products.**

The commercial success of the products and technologies we develop will depend upon the acceptance of these products by physicians and their patients. It is difficult for us to predict how successful recently introduced products and procedures or products we are currently developing, will be over the long term. If the products we develop do not gain market acceptance, our revenues and operating results will suffer. In addition, we expect to face significant competition, in some cases from companies that are more established, market more widely known products and have greater resources than we do. We may not be able to differentiate our new products sufficiently from our competitors' products to achieve significant market penetration. As a result of these factors, we may incur significant sales and marketing expenses for our new products without achieving commercial success, which could harm our business and our competitive position.

In addition, as new or enhanced products are introduced, we must successfully manage the transition from older products in order to minimize disruption in customers' ordering patterns, avoid excessive levels of older product inventories, and ensure that enough supplies of new products can be delivered to meet customer demand.

**The failure of our systems to meet patient expectations or the occurrence of unpleasant side effects from the procedures for which our products are used could impair our financial performance.**

Our future success depends upon patients having a positive experience with the procedures for which our products are used in order to increase physician demand for our products, as a result of both individual patients' repeat business and as a result of word-of-mouth referrals. We believe that patients may be dissatisfied with these procedures if they find them to be too painful. Furthermore, patients may experience temporary swelling or reddening of the skin as a procedural side effect. In rare instances, patients may receive burns, blisters, skin discoloration or skin depressions. Experiencing excessive pain or any of these side effects or adverse events could discourage a patient from having one of the procedures for which our products are used or discourage a patient from having additional procedures or referring these procedures to others. In



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order to generate repeat and referral business, we also believe that patients must be satisfied with the effectiveness of the procedures. Results obtained from the procedures for which our products are used are subjective and may be subtle. A product treatment may produce results that may not meet patients' expectations. If patients are not satisfied with the procedure or feel that it is too expensive for the results obtained, our reputation and future sales will suffer.

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**The conditions of our secured term loan contain certain financial covenants with respect to our performance and other covenants that restrict our activities. If we are unable to comply with these covenants, we would have to negotiate an amendment to the loan agreement or the lender could accelerate the repayment of our indebtedness.**

Our secured term loan contains certain financial covenants which require us to maintain a certain liquidity ratios and specified levels of EBITDA (as defined in the loan agreement) each fiscal quarter. We are also subject to restrictive covenants, including among others covenants that restrict our ability to incur additional indebtedness, to dispose of assets, to effect certain corporate transactions, including specified mergers or acquisitions, and to pay dividends. The loan agreement generally provides for customary events of default, including among others non-payment defaults, covenant defaults, and a default in the event a material adverse change occurs. There is no assurance that we will be able to comply with our financial covenants. Upon the occurrence of an event of default under the term loan, the lender will be entitled to acceleration of all obligations under the loan agreement and an obligation to repay all obligations in full and such event of default could result in an increase to the applicable interest rate of 5.00%. Any acceleration in the repayment of our indebtedness could adversely affect our business and financial condition.

### **We may face problems with our acquisition of Sound Surgical Technologies**

In February 2013, we completed our acquisition of Sound Surgical, a developer, manufacturer and marketer of surgical and non-invasive body shaping products utilizing ultrasound technology.

We cannot be certain that this acquisition will be successful or that we will realize the anticipated benefits of the acquisition. In particular, we may not be able to realize the strategic and operational benefits and objectives we had anticipated, including greater revenue and market opportunities, maintaining industry leadership and consistent profitability. In addition, the demand for our combined product offerings may fluctuate and we may face increased competition in the markets for our products. Any of the following factors, as well as the inability to realize the long-term anticipated efficiencies and synergies of the acquisition of Sound Surgical, may have a material adverse effect on our business, operating results and financial condition. These factors may include:

the potential disruption of the combined company's ongoing business and diversion of management resources;

the difficulty of incorporating acquired products, technology and rights into the combined company's products and services;

the inability to scale up the manufacturing of recently introduced products rapidly enough to satisfy demand;

unanticipated expenses related to integration of operations;

the possibility that we are unsuccessful in marketing the acquired products;

the impairment of relationships with customers as a result of any integration of new personnel;

potential settlement of product liability litigation and claims that exceed available insurance coverage;

the impairment of relationships with key suppliers and their ability to meet our demand;

potential unknown liabilities associated with the acquired business and technology;

potential periodic impairment of goodwill and intangible assets acquired; and

potential inability to retain, integrate and motivate key personnel.

**We have grown, and may continue to grow, through acquisitions, which gives rise to risks and challenges that could adversely affect our future financial results.**

We have in the past acquired, and we expect to acquire in the future, other businesses, business units, and technologies. Acquisitions can involve a number of special risks and challenges, including:

complexity, time, and costs associated with the integration of acquired business operations, workforce, products, and technologies;

diversion of management time and attention;

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loss or termination of employees, including costs associated with the termination or replacement of those employees;

assumption of liabilities of the acquired business, including litigation related to the acquired business;

addition of acquisition-related debt as well as increased expenses and working capital requirements;

dilution of stock ownership of existing stockholders; and

substantial accounting charges for restructuring and related expenses, write-off of in-process research and development, amortization of intangible assets, and stock-based compensation expense.

If integration of our acquired businesses is not successful, we may not realize the potential benefits of an acquisition or may suffer other adverse effects. To integrate acquired businesses, we must implement our technology systems in the acquired operations and integrate and manage the personnel of the acquired operations. We also must effectively integrate the different cultures of acquired business organizations into our own in a way that aligns various interests, and may need to enter new markets in which we have no or limited experience and where competitors in such markets have stronger market positions.

We have substantial amounts of goodwill and purchased intangible assets from prior acquisitions. We test goodwill for impairment at least annually and more frequently if events or changes in circumstances indicate that this asset may be impaired and we review purchased intangible assets for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. We may be required to record impairment charges in the future with respect to these assets recorded from past or future acquisitions.

Any of the foregoing, and other factors, could harm our ability to achieve anticipated levels of profitability from acquired businesses or to realize other anticipated benefits of acquisitions.

As a result of the acquisition of Medicis Technologies Corporation, we may be required to make additional cash payments for attainment of certain targets. We recorded a liability for the contingent consideration payments with a fair value of \$57.1 million at March 31, 2013 based upon a discounted cash flow model that uses significant estimates and assumptions. Any changes to these estimates and assumptions could significantly impact the fair values recorded for this liability resulting in significant charges to our condensed consolidated statements of operations.

**We may incur goodwill impairment charges that would adversely affect our operating results.**

We review goodwill for impairment annually and more frequently if events and circumstances indicate that impairment possibly exists. Factors we would consider important that could trigger an impairment review include, but are not limited to, a significant decline in our stock price for a sustained period and decreases in our market capitalization below the recorded amount of our net assets for a sustained period. Our stock price is highly volatile and has experienced significant declines in the past. We performed our annual review of goodwill as of December 31, 2012 and we determined that an impairment charge was not required. If we have indicators of impairment and assess that the fair value of the company is below the carrying value, an impairment of goodwill may result. The balance of goodwill was \$104.0 million as of March 31, 2013. There can be no assurance that future goodwill impairments will not occur.

**We may fail to effectively build and manage our sales force or to market and distribute our products.**

We rely on a direct sales force to sell our products in the United States and in certain international regions. As the Company grows, we expect to grow or realign our sales organization to meet our anticipated sales objectives. There are significant risks involved in building and managing our sales organization, including risks related to our ability to:

hire qualified individuals as needed;

provide adequate training for the effective sale of our products; and

retain and motivate our sales employees.

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In addition, sales to non-traditional practitioners of aesthetic procedures are a key element of our growth strategy. However, our sales force historically has sold primarily to dermatologists and plastic surgeons. Also, our systems compete with products that are well-established in the market. Accordingly, it is difficult for us to predict how well our sales force will perform. Our failure to adequately address these risks could have a material adverse effect on our ability to sell our products, causing our revenue to be lower than expected and harming our results of operations.

### **We may be involved in intellectual property litigation, which could be costly and time consuming, and may impact our future business and financial performance.**

Litigation related to infringement and other intellectual property claims, with or without merit, is unpredictable, can be expensive and time-consuming and could divert management's attention from our core business. If we lose this kind of litigation, a court could require us to pay substantial damages, and prohibit us from using technologies essential to our products, any of which would have a material adverse effect on our business, results of operations and financial condition. We do not know whether necessary licenses would be available to us on satisfactory terms, or whether we could redesign our products or processes to avoid infringement.

Our industry has been characterized by frequent intellectual property litigation. Our competitors or other patent holders may assert that our products and the methods we employ are covered by their patents, and we have, from time to time, received notices of potential infringement by us of other parties' patents. If our products or methods are found to infringe, we could be prevented from marketing them. In addition, we do not know whether our competitors or potential competitors have applied for, or will apply for or obtain, patents that will prevent, limit or interfere with our ability to make, use, sell, import or export our products. Competing products may also appear in other countries in which our patent coverage might not exist or be as strong. If we lose a foreign patent lawsuit, we could be prevented from marketing our products in one or more countries.

In addition, we may hereafter become involved in litigation to protect our trademark rights associated with our company name or the names used with our products. Names used with our products and procedures may be claimed to infringe names held by others or to be ineligible for proprietary protection. If we have to change the name of our company or products, we may experience a loss in goodwill associated with our brand name, customer confusion and a loss of sales.

### **We are involved in litigation relating to our acquisition of Reliant Technologies, Inc., which could be costly and time consuming.**

On December 21, 2009, a complaint was filed in the Santa Clara County Superior Court by three former stockholders of Reliant Technologies, Inc ( Reliant ) against Reliant and certain former officers and directors of Reliant in connection with the Company's acquisition of Reliant, which closed on December 23, 2008. The complaint purports to be brought on behalf of the former common stockholders of Reliant. As a result of the acquisition, a successor entity to Reliant, Reliant Technologies, LLC, became our wholly-owned subsidiary. One member of our Board of Directors and our former Chief Technology Officer and former member of our Board of Directors are among the defendants named in the complaint. The principal claim, among others, is that Reliant violated the California Corporations Code by failing to obtain the vote from a majority of holders of Reliant's common stock prior to the consummation of the acquisition. The complaint also purports to challenge disclosures made by Reliant in connection with its entry into the acquisition and alleges that the defendants failed to maximize the value of Reliant for the benefits of Reliant's common stockholders. On August 2, 2010, defendants filed a motion to dismiss or stay the entire action based on a mandatory forum selection clause in the merger agreement which requires that claims related to the merger be litigated in Delaware. On September 28, 2010, the Court granted the defendants' motion to dismiss or stay, and stayed the action indefinitely. On January 20, 2012, the Court dismissed plaintiffs' case without prejudice. Plaintiffs have appealed. To date, the plaintiffs have not filed a complaint against the defendants in Delaware. We believe that this suit is without merit, and we intend to vigorously defend it. Although we do not expect that the final disposition of this litigation will have a material effect on its financial results, we expect to devote certain personnel and resources to resolve this litigation.

### **From time to time we are a party to lawsuits, which often require significant management time and attention and result in significant legal expenses, and which could, if not determined favorably, negatively impact our business, financial condition, results of operations, and cash flows.**

From time to time, including at the present time, we are a party to litigation with respect to the conduct of our business, including the conduct of business by companies we have acquired. The expense of defending such litigation may be costly and divert management's attention from the day-to-day operations of our business, which could adversely affect our business, results of operations, and cash flows. In addition, an unfavorable outcome in such litigation could result in significant monetary damages or injunctive relief that could negatively impact our ability to conduct our business, results of operations, and cash flows.



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**Intellectual property rights may not provide adequate protection for our products, which may permit third parties to compete against us more effectively.**

We rely on a combination of patent, copyright, trademark and trade secret laws and confidentiality and invention assignment agreements to protect our intellectual property rights. As of March 31, 2013, we had 140 issued U.S. patents, 90 pending U.S. patent applications, 137 issued foreign patents and 126 pending foreign patent applications, some of which foreign applications preserve an opportunity to pursue patent rights in multiple countries. Some of our system components are not, and in the future may not be, protected by patents. Additionally, our patent applications may not issue as patents or, if issued, may not issue in a form that will be advantageous to us. Any patents we obtain may be challenged, invalidated or legally circumvented by third parties. Consequently, competitors could market products and use manufacturing processes that are substantially similar to, or superior to, ours. We may not be able to prevent the unauthorized disclosure or use of our technical knowledge or other trade secrets by consultants, vendors, former employees or current employees, despite the existence generally of confidentiality agreements and other contractual restrictions. Monitoring unauthorized uses and disclosures of our intellectual property is difficult, and we do not know whether the steps we have taken to protect our intellectual property will be effective. Moreover, we do not have patent rights in all foreign countries in which a market may exist, and where we have applied for foreign patent rights, the laws of many foreign countries will not protect our intellectual property rights to the same extent as the laws of the United States.

In addition, competitors could purchase our systems and attempt to replicate some or all of the competitive advantages we derive from our development efforts, willfully infringe our intellectual property rights, design around our protected technology or develop their own competitive technologies that fall outside of our intellectual property rights. If our intellectual property is not adequately protected so as to protect our market against competitors' products and methods, our competitive position could be adversely affected, as could our business.

**Performing clinical studies on, and collecting data from the procedures for which our products are used is inherently subjective, and we have limited data regarding the efficacy of our systems. If future data is not positive or consistent with our prior experience, rates of physician adoption will likely be harmed.**

We believe that in order to significantly grow our business, we will need to conduct future clinical studies of the effectiveness of our systems. Clinical studies of aesthetic treatments are subject to a number of limitations. First, these studies do not involve well-established objective standards for measuring the effectiveness of treatment. Subjective, before and after, evaluation of the extent of change in the patient's appearance, performed by a medical professional or by the patient, is the most common method of evaluating effectiveness. A clinical study may conclude that a treatment is effective even if the change in appearance is subtle and not long-lasting. Second, as with other non-invasive or minimally invasive energy-based devices, the effects of the procedures for which our products are used vary from patient to patient and can be influenced by a number of factors, including the area of the body being treated, the age and skin laxity of the patient and operator technique.

We have not conducted any head-to-head clinical studies that compare results from treatment with our systems to surgery or treatment with other aesthetic devices. Without head-to-head studies against competing alternative treatments, potential customers may not find clinical studies of our technology sufficiently compelling to purchase our systems. If we decide to pursue additional studies in the future, they could be expensive and time consuming, and the data collected may not produce favorable or compelling results. If the results of such studies do not meet physicians' expectations, our systems may not become widely adopted, physicians may recommend alternative treatments for their patients, and our business may be harmed.

**To successfully market and sell our systems internationally, we must address many issues with which we have limited experience.**

Sales outside of North America accounted for 51%, 55% and 55% of our revenue for the years ended December 31, 2012, 2011 and 2010. We believe that a significant portion of our business will continue to come from international sales through increased penetration in countries where we currently sell our products, combined with expansion into new international markets. However, international sales are subject to a number of risks, including:

difficulties in staffing and managing our international operations;

difficulties in penetrating markets in which our competitors' products are more established;



reduced or no protection for intellectual property rights in some countries;

export restrictions, trade regulations and foreign tax laws;

regulation of the sale of the hydrofluorocarbon used with our Thermage and Isolaz systems;

fluctuating foreign currency exchange rates;

foreign certification and regulatory clearance or approval requirements;

difficulties in developing effective marketing campaigns for unfamiliar, foreign countries;

dependence on third-party distributors in some territories;

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customs clearance and shipping delays;

political and economic instability;

natural disasters (such as earthquakes, hurricanes, tsunamis, floods or storms);

preference for locally produced products;

business interruption resulting from transitioning to direct sales from international distributors in certain international regions; and

difficulties in getting distributors to relinquish regulatory documentation.

If one or more of these risks were realized, it could require us to dedicate significant resources to remedy the situation, and if we are unable to find a solution, our revenue may decline.

**To market and sell our products internationally, we depend on distributors, and they may not be successful.**

We currently depend primarily on third-party distributors to sell and service our products internationally and to train our international customers, and if these distributors terminate their relationships with us or under-perform we may be unable to maintain or increase our level of international revenue. We will also need to engage additional international distributors to grow our business and expand the territories in which we sell our systems. Distributors may not commit the necessary resources to market, sell and service our products to the level of our expectations. If current or future distributors do not perform adequately, or if we are unable to engage distributors in particular geographic areas, our revenue from international operations will be adversely affected. In addition, from time to time, legal disputes arise when we wish to discontinue a distributor relationship in a given territory or otherwise feel a distributor is not performing adequately. Such disputes have led to legal proceedings that are costly to litigate and that could result in outcomes that are not favorable to us.

**We face significant uncertainty in the industry due to government healthcare reform.**

Political, economic and regulatory influences are subjecting the healthcare industry to fundamental changes. The Patient Protection and Affordable Care Act (the Healthcare Act) signed into law in March 2010 enacted sweeping reforms to the U.S. healthcare industry, including mandatory health insurance, reforms to Medicare and Medicaid, the creation of large insurance purchasing groups, new taxes on medical equipment manufacturers and other significant modifications to the healthcare delivery system. Due to uncertainties regarding the ultimate features of the new federal legislation and its implementation, we cannot predict what impact the Healthcare Act may have on us, our customers or our industry. A material amount of our sales are subject to the medical device excise tax included in the Healthcare Act, which is a 2.3% tax to be levied on a significant portion of our total domestic sales of medical devices. The tax is calculated using sales price, irrespective of a company's profitability. The excise tax provisions went into effect January 1, 2013.

**We compete against companies that have more established products, longer operating histories and greater resources, which may prevent us from achieving significant market penetration or increased operating results.**

The aesthetics market is highly competitive and dynamic, and is marked by rapid and substantial technological development and product innovations. Demand for our products could be diminished by equivalent or superior products and technologies offered by competitors. Specifically, our products compete against a variety of offerings in the aesthetics market, including laser and other light-based medical devices, pharmaceutical products such as Botox, filler injections, chemical peels, microdermabrasion, liposuction, cosmetic surgical procedures and less invasive surgical solutions such as implanted sutures. We compete against products and procedures using laser, light-based, RF, ultrasound, and other aesthetic energy modalities for skin resurfacing and rejuvenation, skin tightening, body contouring, and acne treatment from companies such as Alma Laser, Cutera, Cynosure, Erchonia, Lumenis, Lutronic, Palomar, MedixSysteme, Real Aesthetics, Sciton, Sybaritic, Syneron, Ulthera, Ultrashape, and Zeltiq. Our consumer device competes against companies that offer laser, LED and other aesthetic energy devices for skin rejuvenation and acne treatment such as Clarisonic, Palomar, PhotoMedex, Syneron, Tria Beauty and Zeno.



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Competition in the aesthetics market could result in price-cutting, reduced profit margins and loss of market share, any of which would harm our business, financial condition and results of operations. Our ability to compete effectively depends upon our ability to distinguish our company and our products from our competitors and their products, and on such factors as:

safety and effectiveness;

product pricing;

success of our marketing initiatives;

compelling clinical data;

intellectual property protection;

quality of customer support; and

development of successful distribution channels, both domestically and internationally.

Some of our competitors have more established products and customer relationships than we do, which could inhibit our market penetration efforts. For example, we have encountered, and expect to continue to encounter, situations where, due to pre-existing relationships, potential customers decided to purchase additional products from our competitors. Potential customers also may need to recoup the cost of expensive products that they have already purchased from our competitors and thus may decide not to purchase our products, or to delay such purchase. If we are unable to achieve continued market penetration, we will be unable to compete effectively and our business will be harmed.

In addition, some of our current and potential competitors have significantly greater financial, research and development, manufacturing, and sales and marketing resources than we have. Our competitors could utilize their greater financial resources to acquire other companies to gain enhanced name recognition and market share, as well as new technologies or products that could effectively compete with our existing product lines. Given the relatively few competitors currently in the market, any business combination could exacerbate any existing competitive pressures, which could harm our business.

### **Competition among providers of devices for the aesthetics market is characterized by rapid innovation, and we must continuously develop new products or our revenue may decline.**

While we attempt to protect our products through patents and other intellectual property rights, there are few barriers to entry that would prevent new entrants or existing competitors from developing products that compete directly with ours. If we continue to create market demand for non-surgical, non-invasive or minimally invasive treatments, competitors will enter the market with other products making similar or superior claims. We expect that any competitive advantage we may enjoy from our current and future innovations may diminish over time, as companies successfully respond to our, or create their own, innovations. Consequently, we believe that we will have to continuously innovate and improve our products and technology to compete successfully. If we are unable to innovate successfully, our systems could become obsolete and our revenue will decline as our customers purchase competing products.

Our products may have undetected and unforeseen design flaws, and may experience failures particularly when first introduced, or at any time during their lifecycle. Any product recall as a result of flaws or failures could result in the loss of or delays in market acceptance of our products and adversely affect our business and reputation. Correcting defects can be time consuming. Any significant returns or warranty claims could result in significant additional costs to us and could adversely affect our results of operations.

**Negative publicity regarding our current or future products and procedures could harm demand, which would adversely affect sales and our financial performance.**

We have in the past experienced, and expect that in the future we will experience, negative media exposure. Such publicity may present negative individual physician or patient experience regarding the safety or effectiveness of our procedures. Competitors could attempt to use such publicity to harm our reputation and disrupt current or potential future customer relationships. While, to date, we have not observed a material impact on our quarterly financial results of operations from negative publicity, future results could be negatively impacted. Additionally, while we believe that obtaining positive publicity is important to our success, and it is an important component of our marketing efforts, we have also not observed a material impact on our quarterly financial results of operations from positive publicity.

Our reputation and competitive position may be harmed not only by negative media exposure, but also by other publicly-available information suggesting that our procedures are not safe. For example, we file reports with the FDA that are publicly available on the FDA's website if our products may have caused or contributed to a serious injury or malfunctioned in a way that would likely cause or contribute to a serious injury if it were to recur. Competitors may attempt to harm our reputation by pointing to isolated injuries that have been reported or publicized, or by claiming that their product is superior because they have not filed as many reports with the FDA. Such negative publicity and competitor behavior could harm our reputation and our future sales.

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**Our manufacturing operations and those of our key manufacturing subcontractors are dependent upon third-party suppliers, making us vulnerable to supply shortages and price fluctuations, which could harm our business.**

Several components and materials that comprise our products are currently manufactured by a single supplier or a limited number of suppliers. In many of these cases, we have not yet qualified alternate suppliers and rely upon purchase orders, rather than long-term supply agreements. A supply interruption or an increase in demand beyond our current suppliers' capabilities could harm our ability to manufacture our products until new sources of supply are identified and qualified. Our reliance on these suppliers subjects us to a number of risks that could harm our business, including:

interruption of supply resulting from modifications to or discontinuation of a supplier's operations;

delays in product shipments resulting from uncorrected defects, reliability issues or a supplier's variation in a component;

a lack of long-term supply arrangements for key components with our suppliers;

inability to obtain adequate supply in a timely manner, or to obtain adequate supply on commercially reasonable terms;

difficulty locating and qualifying alternative suppliers for our components in a timely manner;

production delays related to the evaluation and testing of products from alternative suppliers, and corresponding regulatory qualifications;

delay in delivery due to our suppliers prioritizing other customer orders over ours;

damage to our brand reputation caused by defective components produced by our suppliers;

interruption or delay of supply due to a natural disaster affecting supplier's operations;

increased cost of our warranty program due to product repair or replacement based upon defects in components produced by our suppliers; and

fluctuation in delivery by our suppliers due to changes in demand from us or their other customers.

Any interruption in the supply of components or materials, or our inability to obtain substitute components or materials from alternate sources at acceptable prices in a timely manner, could impair our ability to meet the demand of our customers, which would have an adverse effect on our business.

**If, in the future, we decide to perform additional manufacturing functions internally that we currently outsource, our business could be harmed by our limited manufacturing experience and related capabilities.**

We currently perform certain value-added and proprietary manufacturing processes internally at our principal facility, and we outsource the manufacture of components, subassemblies and certain finished products to a limited number of third parties. For financial or operational

purposes, we may elect to perform additional component or system manufacturing functions internally. In that event, we may face a number of challenges beyond those that we currently address in our internal assembly, inspection, testing and certification activities. Implementing complex or specialized manufacturing processes could lead to difficulties in producing sufficient quantities of manufactured items that meet our quality standards and that comply with applicable regulatory requirements in a timely and cost-effective manner. In addition, if we experience these types of internal manufacturing difficulties, it may be expensive and time consuming to engage a new or previous subcontractor or supplier to fulfill our replacement manufacturing needs. The occurrence of any of these events could harm our business.

Problems in our manufacturing processes, or those of our manufacturing subcontractors, that lead to an actual or possible malfunction in our products, may require us to recall products from customers and could disrupt our operations. Our results of operations, our reputation and market acceptance of our products could be harmed if we encounter difficulties in manufacturing that result in a recall or patient injury, and delays in our ability to fill customer orders.

**We outsource the repair of key elements of some products to sole-source service subcontractors.**

We outsource the repair of certain key elements of our systems to sole source contract service providers. If the operations of those service subcontractors are interrupted, we may be limited in our ability to repair equipment. Our service subcontractors are dependent on trained technical labor to effectively repair our products. In addition, our service subcontractors may be operating as medical device manufacturers and as such are required to demonstrate and maintain compliance with the Quality System Review ( QSR ). If our service subcontractors fail to comply with the QSR, repair operations could be affected and our ability to repair certain systems may be impaired.

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### **We may not be able to develop an alternative cooling system that will be in compliance with changing environmental regulations in a timely or cost-effective manner.**

The cooling capability of our Thermage and Isolaz systems relies upon a hydrofluorocarbon, or HFC, called R134a, to protect the outer layer of the skin from over-heating while our device delivers RF energy to the subcutaneous tissue. New environmental regulations phasing out certain HFCs over the next decade have been adopted or are under consideration in a number of countries, and recent European Union directives require the phase-out of certain HFCs. We have also put in place a solution for the European Union import restrictions. If we are unable to develop an alternative cooling system for our device which is not dependent on R134a in a timely or cost-effective manner, our Thermage and Isolaz systems may not be in compliance with environmental regulations, which could result in fines, civil penalties and the inability to sell our products in certain major international markets.

### **We forecast sales to determine requirements for components and materials used in our systems, and if our forecasts are incorrect, we may experience delays in shipments or increased inventory costs.**

We keep limited materials, components and finished product on hand. To manage our manufacturing operations with our suppliers, we forecast anticipated product orders and material requirements to predict our inventory needs up to six months in advance and enter into purchase orders on the basis of these requirements. Our limited historical experience may not provide us with enough data to accurately predict future demand. If our business expands, our demand for components and materials would increase and our suppliers may be unable to meet our demand. If we overestimate our component and material requirements, we will have excess inventory, which would increase our expenses. If we underestimate our component and material requirements, we may have inadequate inventory, which could interrupt, delay or prevent delivery of systems to our customers. Any of these occurrences would negatively affect our financial performance and the level of satisfaction our customers have with our business.

### **Even though we require training for users of our professional systems, there exists a potential for misuse, which could harm our reputation and our business.**

U.S. federal regulations allow us to sell our professional systems to licensed practitioners. The definition of licensed practitioners varies from state to state. As a result, our professional systems may be operated by licensed practitioners with varying levels of training, and in many states by non-physicians, including physician assistants, registered nurses and nurse practitioners. Thus, in some states, the definition of licensed practitioner may result in the legal use of our professional products by non-physicians. Outside the United States, our independent distributors sell in many jurisdictions that do not require specific qualifications or training for purchasers or operators of products. We do not supervise the procedures performed with our professional systems, nor can we be assured that direct physician supervision of our equipment occurs according to our recommendations. We, and our distributors, require purchasers of our professional products to undergo an initial training session as a condition of purchase, but do not require ongoing training. In addition, we prohibit the sale of our professional systems to companies that rent our systems to third parties without our approval, but cannot prevent an otherwise qualified physician from contracting with a rental company in violation of their purchase agreement with us. The use of our professional systems by non-physicians, as well as noncompliance with the operating guidelines set forth in our training programs, may result in product misuse and adverse treatment outcomes, which could harm our reputation and expose us to costly product liability litigation.

### **Product liability suits could be brought against us due to defective design, labeling, material or workmanship, or misuse of our products, and could result in expensive and time-consuming litigation, payment of substantial damages and an increase in our insurance rates.**

If our products are defectively designed, manufactured or labeled, contain defective components or are misused, we may become subject to substantial and costly litigation by our customers or their patients. For example, as described under Legal Proceedings, one such litigation matter is currently pending. Misusing our products or failing to adhere to operating guidelines could cause significant skin damage and underlying tissue damage. In addition, if our operating guidelines or product design are found to be inadequate, we may be subject to liability. We have been, continue to be and may, in the future, be involved in litigation related to the use of our products. Product liability claims could divert management's attention from our core business, be expensive to defend and result in sizable damage awards against us. We may not have sufficient insurance coverage for all future claims. We may not be able to obtain insurance in amounts or scope sufficient to provide us with adequate coverage against all potential liabilities. Any product liability claim brought against us, with or without merit, could increase our product liability insurance rates or prevent us from securing continuing coverage, could harm our reputation in the industry and reduce product sales. Product liability claims in excess of our insurance coverage would be paid out of cash reserves, harming our financial condition and reducing our operating results.





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**After-market modifications to our treatment tips by third parties and the development of counterfeit treatment tips could reduce our sales, expose us to product liability litigation and dilute our brand quality.**

Third parties have introduced adulterated after-market modifications to our treatment tips which have enabled re-use of our treatment tips in multiple procedures. Because our treatment tips are designed to withstand a finite number of firings, modifications intended to increase the number of firings could result in patient injuries caused by the use of worn-out or damaged treatment tips. In addition, third parties may seek to develop counterfeit treatment tips that are compatible with our systems and available to practitioners at lower prices than our own. If security features incorporated into the design of our systems are unable to prevent after-market modifications to our treatment tips or the introduction of counterfeit treatment tips, we could be subject to reduced treatment tip sales, product liability lawsuits resulting from the use of damaged or defective goods and damage to our reputation for providing a quality product.

**We depend on skilled and experienced personnel to operate our business effectively. If we are unable to recruit, hire and retain these employees, our ability to manage and expand our business will be harmed, which would impair our future revenue and profitability.**

Our success largely depends on the skills, experience and efforts of our officers and other key employees. Many of our officers and key employees do not have employment contracts with us and can terminate their employment at any time. The loss of any of our senior management team members could weaken our management expertise and harm our business.

Our ability to retain our skilled labor force and our success in attracting and hiring new skilled employees will be a critical factor in determining whether we will be successful in the future. We may not be able to meet our future hiring needs or retain existing personnel. We will face particularly significant challenges and risks in hiring, training, managing and retaining engineering and sales and marketing employees, as well as independent distributors, most of whom are geographically dispersed and must be trained in the use and benefits of our products. Failure to attract and retain personnel, particularly technical and sales and marketing personnel, would materially harm our ability to compete effectively and grow our business.

### **Risks Related to Regulatory Matters**

**If we fail to obtain and maintain necessary FDA clearances for our systems and indications, if clearances for future products and indications are delayed, not issued or rescinded or if there are federal or state level regulatory changes, our commercial operations would be harmed.**

Our systems are medical devices that are subject to extensive regulation in the United States by the FDA for manufacturing, labeling, sale, promotion, distribution and shipping. Before a new medical device, or a new use of or claim for an existing product, can be marketed in the United States, it must first receive either 510(k) clearance or premarket approval from the FDA, unless an exemption applies. Either process can be expensive and lengthy. The FDA's 510(k) clearance process usually takes from three to six months from the time the application is filed with the FDA, but it can take significantly longer. The process of obtaining premarket approval is much more costly and uncertain than the 510(k) clearance process, and it generally takes from one to three years, or even longer, from the time the application is filed with the FDA.

Medical devices may be marketed only for the indications for which they are approved or cleared. We have obtained 510(k) clearance for various indications for our Thermage and Fraxel systems. In addition, 510(k) clearance has been obtained for various indications of our recently acquired Isolaz systems, CLARO products and Liposonix systems. However, our clearances can be revoked if safety or effectiveness problems develop. We are also subject to Medical Device Reporting regulations, which require us to report to the FDA if our product causes or contributes to a death or serious injury, or malfunctions in a way that would likely cause or contribute to a death or serious injury if the malfunction were to recur. Our products are also subject to state regulations which are, in many instances, in flux. Changes in state regulations may impede sales. For example, federal regulations allow our systems to be sold to, or on the order of, licensed practitioners, as determined on a state-by-state basis. As a result, in some states, non-physicians may legally purchase and operate our systems. However, a state could change its regulations at any time, disallowing sales to particular types of end users. We cannot predict the impact or effect of future legislation or regulations at the federal or state levels.

The FDA and state authorities have broad enforcement powers. Our failure to comply with applicable regulatory requirements could result in enforcement action by the FDA or state agencies, which may include any of the following sanctions:

warning letters, fines, injunctions, consent decrees and civil penalties;

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repair, replacement, refunds, recall or seizure of our products;

operating restrictions or partial suspension or total shutdown of production;

refusing our requests for 510(k) clearance or premarket approval of new products, new intended uses or modifications to our existing products;

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withdrawing 510(k) clearance or premarket approvals that have already been granted; and

criminal prosecution.

If any of these events were to occur, our business could be harmed.

**If we modify our FDA-cleared devices, we may need to seek and obtain new clearances, which, if not granted, would prevent us from selling our modified product or require us to redesign our product.**

Any modification to an FDA-cleared device that would significantly affect its safety or effectiveness or that would constitute a change in its intended use would require a new 510(k) clearance or possibly a premarket approval. We may not be able to obtain additional 510(k) clearances or premarket approvals for new products or for modifications to, or additional indications for, our existing products in a timely fashion, or at all. Delays in obtaining future clearances would adversely affect our ability to introduce new or enhanced products in a timely manner, which in turn would harm our revenue and potential future profitability. We have made modifications to our devices in the past and may make additional modifications in the future that we believe do not or will not require additional clearances or approvals. If the FDA disagrees, and requires new clearances or approvals for the modifications, we may be required to recall and to stop marketing the modified devices, which could harm our operating results and require us to redesign our products.

**If we or our suppliers and subcontractors fail to comply with the QSR, our business would suffer.**

We and our suppliers and subcontractors are required to demonstrate and maintain compliance with the QSR. The QSR is a complex regulatory scheme that covers the methods and documentation of the design, testing, control, manufacturing, labeling, quality assurance, packaging, storage and shipping of our products. The FDA enforces the QSR through periodic inspections. We and our suppliers have been, and we anticipate that we and our suppliers will in the future be, subject to such inspections. In addition, certain of our suppliers have, from time to time, received warning letters from the FDA regarding potential non-compliance. Our failure, or the failure of our suppliers and subcontractors, to take satisfactory corrective action in response to an adverse QSR inspection could result in enforcement actions, including a public warning letter, a shutdown of our manufacturing operations, a recall of our products, civil or criminal penalties or other sanctions, which would cause our sales and business to suffer.

**We may be unable to obtain or maintain international regulatory certifications or approvals for our current or future products and indications, which could harm our business.**

To support the marketing of our products outside the United States, we must comply with and be certified to the ISO 13485: 2003 Quality Management System Standard. Failure to adequately maintain our ISO 13485: 2003 certifications may adversely impact or prevent the marketing of our products internationally. In markets where we sell through distributors, we primarily rely upon distributors to obtain all regulatory licenses, registrations and approvals required in countries outside of the United States, and these distributors may be unable to obtain or maintain such licenses, registrations and approvals. Our distributors may also incur significant costs in attempting to obtain and in maintaining regulatory licenses, registrations and approvals, which could increase the difficulty of attracting and retaining qualified distributors. If our distributors experience delays in receiving necessary licenses, registrations or approvals to market our products outside the United States, or if they fail to receive those licenses, registrations or approvals, we may be unable to market our products or product enhancements in international markets effectively, or at all.

**Risks Related to Our Internal Control over Financial Reporting**

**While we believe we currently have adequate internal control over financial reporting, we are required to assess our internal control over financial reporting on an annual basis and any future adverse results from such assessment could result in a loss of investor confidence in our financial reports and have an adverse effect on our stock.**

Pursuant to the Sarbanes-Oxley Act of 2002 and the rules and regulations promulgated by the SEC, we are required to maintain disclosure controls and procedures and adequate internal control over financial reporting. Under such requirements we must furnish in our Form 10-K a report by our management regarding the effectiveness of our internal control over financial reporting. The report includes, among other things, an assessment of the effectiveness of our internal control over financial reporting as of the end of our fiscal year, including a statement as to whether or not our internal control over financial reporting is effective. This assessment must include disclosure of any material weaknesses in our internal control over financial reporting identified by management. While we currently believe our internal control over financial reporting is effective, the effectiveness of our internal controls in future periods is subject to the risk that our controls may become inadequate because of changes in conditions. The effectiveness of our controls and procedures may in the future be limited by a variety of factors, including:

faulty human judgment and simple errors, omissions or mistakes;

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fraudulent action of an individual or collusion of two or more people;

inappropriate management override of procedures; and

the possibility that any enhancements to controls and procedures may still not be adequate to assure timely and accurate financial information.

If we are unable to assert that our internal control over financial reporting is effective in any future period, or if and when applicable, our auditors are unable to express an opinion on the effectiveness of our internal controls, or conclude that our internal controls are ineffective, or if we fail to maintain adequate and effective internal control over financial reporting, we could lose investor confidence in the accuracy and completeness of our financial reports, which could have an adverse effect on our stock price.

**Risks Related to Our Common Stock**

**We expect that the price of our common stock will fluctuate substantially.**

The market price of our common stock has historically been, and is likely to continue to be, highly volatile and may fluctuate substantially due to many factors, including:

fluctuations in our operating results and the operating results of our competitors;

changes in earnings estimates or recommendations regarding us or our competitors by securities analysts;

volume and timing of sales of our products;

conditions and trends in our industry and the markets we serve;

the introduction and market acceptance of new products or product enhancements by us or our competitors;

our ability to develop, obtain regulatory clearance or approval for and market new and enhanced products on a timely basis;

changes in our pricing policies or the pricing policies of our competitors;

announcements of significant new contracts, acquisitions or strategic alliances by us or our competitors;

our ability to successfully integrate acquired companies or technologies;

disputes or other developments with respect to our intellectual property rights or the intellectual property rights of others;

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product liability claims or other litigation;

changes in accounting principles or changes in interpretations of existing principles, which could affect our financial results;

sales of large blocks of our common stock, including sales by our executive officers and directors;

media exposure of our products or products of our competitors;

changes in legislation and governmental regulations or in the status of our regulatory approvals or applications; and

general market conditions and other factors, including factors unrelated to our operating performance or the operating performance of our competitors.

These and other factors may make the price of our stock volatile and subject to unexpected fluctuation.

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### **A sale of a substantial number of shares of our common stock may cause the price of our common stock to decline.**

As of March 31, 2013, we had 79.3 million shares of our common stock outstanding. We may be required to issue up to 3.6 million additional shares in 2014 as contingent consideration in the Sound Surgical acquisition. If our stockholders sell substantial amounts of our common stock in the public market, for example, liquidation of shares held by our principal stockholders, including shares issued upon the exercise of outstanding options, the market price of our common stock could decline. These sales also might make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem appropriate.

If our stockholders sell substantial amounts of our common stock in the public market, for example, liquidation of shares held by our principal stockholders, including shares issued upon the exercise of outstanding options, the market price of our common stock could decline. These sales also might make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem reasonable or appropriate.

### **Our directors, officers and principal stockholders have significant voting power and may take actions that may not be in the best interests of our other stockholders.**

Our officers, directors and principal stockholders holding more than 5% of our common stock collectively control approximately 21% of our outstanding common stock. As a result, these stockholders, if they act together, will be able to significantly influence the management and affairs of our company and most matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions. This concentration of ownership may have the effect of delaying or preventing a change in control and might adversely affect the market price of our common stock. This concentration of ownership may not be in the best interests of our other stockholders.

### **Anti-takeover provisions in our Amended and Restated Certificate of Incorporation and Bylaws, and Delaware law, contain provisions that could discourage a takeover.**

Our certificate of incorporation and bylaws, and Delaware law, contain provisions that might enable our management to resist a takeover, and might make it more difficult for an investor to acquire a substantial block of our common stock. These provisions include:

a classified board of directors;

advance notice requirements to stockholders for matters to be brought at stockholder meetings;

a supermajority stockholder vote requirement for amending certain provisions of our Amended and Restated Certificate of Incorporation and Bylaws;

limitations on stockholder actions by written consent; and

the right to issue preferred stock without stockholder approval, which could be used to dilute the stock ownership of a potential hostile acquirer.

These provisions might discourage, delay or prevent a change in control of our company or a change in our management. The existence of these provisions could adversely affect the voting power of holders of common stock and limit the price that investors might be willing to pay in the future for shares of our common stock.

### **We have not paid dividends in the past and do not expect to pay dividends in the future, and any return on investment may be limited to the value of our stock.**

We have never paid cash dividends on our common stock and do not anticipate paying cash dividends on our common stock in the foreseeable future. The payment of dividends on our common stock will depend on our earnings, financial condition and other business and economic



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factors affecting us at such time as our board of directors may consider relevant. If we do not pay dividends, our stock may be less valuable because a return on your investment will only occur if our stock price appreciates.

**If our public guidance or our future operating performance does not meet investor expectations, our stock price could decline.**

We provide guidance to the investing community regarding our anticipated future operating performance. Our business typically has a short sales cycle, so that we do not have significant backlog of orders at the start of a quarter, and our ability to sell our products successfully is subject to many uncertainties, including those discussed in the foregoing risk factors. In light of these factors, and the uncertainty as a result of the general economic situation, it is difficult for us to estimate with accuracy our future results. Our expectations regarding these results will be subject to numerous risks and uncertainties that could make actual results differ materially from those anticipated. If our actual results do not meet our public guidance or our guidance or actual results do not meet the expectations of third-party financial analysts, our stock price could decline significantly.

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**If equity research analysts do not publish research or reports about our business or if they issue unfavorable commentary or downgrade our common stock, the price of our common stock could decline.**

The trading market for our common stock relies in part on the research and reports that equity research analysts publish about us and our business. We do not control these analysts. The price of our common stock could decline if one or more equity analysts downgrade our common stock or if analysts issue other unfavorable commentary or cease publishing reports about us or our business.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4. MINE SAFETY DISCLOSURE**

None.

**ITEM 5. OTHER INFORMATION**

None.

**Table of Contents****ITEM 6. EXHIBITS**

Exhibit Number	Description	Form	Incorporated by Reference			Filed Herewith
			File No.	Exhibit	Date Filed	
1.1	Underwriting Agreement between the Company and Canaccord Genuity Inc., as representative of the Underwriters, dated August 2, 2012	8-K	001-33123	1.1	August 2, 2012	
3.1	Amended and Restated Certificate of Incorporation	S-1/A	333-13650	3.3	November 9, 2006	
3.2	Amended and Restated Bylaws	8-K	001-33123	3.1	April 12, 2012	
10.1	Agreement and Plan of Merger dated as of January 29, 2013 among Sound Surgical, Solta and Argonaut Limited Liability Company, a wholly-owned subsidiary of Solta, and Inlign CP III, LLC, acting solely in the capacity of Representative.	8-K	001-33123	10.1	February 26, 2013	
10.2	Ninth Amendment to Loan and Security Agreement dated as of March 18, 2013 by and between Solta Medical, Inc. and Silicon Valley Bank.	8-K	001-33123	10.1	March 31, 2013	
10.3	Lease Agreement between Sound Surgical Technologies LLC and McCaslin Plaza, LLC dated May 30, 2003.					X
10.4	First Amendment to Lease Agreement between Sound Surgical Technologies LLC and McCaslin Plaza, LLC effective August 1, 2006.					X
10.5	Second Amendment to Lease Agreement between Sound Surgical Technologies LLC and McCaslin Plaza, LLC effective August 3, 2011.					X
10.6	Third Amendment to Lease Agreement between Sound Surgical Technologies LLC and McCaslin Plaza, LLC dated September 21, 2012.					X
31.1	Certification of Chief Executive Officer under Securities Exchange Act Rule 13a-14(a).					X
31.2	Certification of Chief Financial Officer under Securities Exchange Act Rule 13a-14(a).					X
32.1	Certifications of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. 1350 and Securities Exchange Act Rule 13a-14(b).					X
101.INS**	XBRL Instance Document.					X
101.SCH**	XBRL Taxonomy Extension Schema Document.					X
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase Document.					X
101.DEF**	XBRL Taxonomy Extension Definition Linkbase Document.					X
101.LAB**	XBRL Taxonomy Extension Labels Linkbase Document.					X
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase Document.					X

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Pursuant to applicable securities laws and regulations, the Registrant is deemed to have complied with the reporting obligation relating to the submission of interactive data files in such exhibits and is not subject to liability under any anti-fraud provisions of the federal securities laws as long as the Registrant has made a good faith attempt to comply with the submission requirements and promptly amends the interactive data files after becoming aware that the interactive data files fails to comply with the submission requirements. These interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act, are deemed not filed for purposes of section 18 of the Exchange Act and otherwise are not subject to liability under these sections.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SOLTA MEDICAL, INC.

Date: May 3, 2013

/s/ Stephen J. Fanning  
Stephen J. Fanning  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: May 3, 2013

/s/ John F. Glenn  
John F. Glenn  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

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